The Case for the Augmented Estate

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Introduction

Since 1990, David Allen, Chairman of the Estate Planning and Trust Law Committee on Statutory Share of Surviving Spouse, has been working on a plan for Ohio to implement legislation that would utilize the "augmented estate" as the basis for the surviving spouse's

elective share rights. Currently, a surviving spouse's elective share rights impact only probate property, making it entirely possible to completely disinherit one's spouse through the use of nonprobate transfers such as payable on death accounts, transfer on death deeds, joint and survivorship assets, inter vivos trusts funded during lifetime and inter vivos gifts.

This result can be completely unfair since a surviving spouse may be deprived of assets that would be considered marital assets subject to equitable division in a divorce proceeding, but be deprived of such assets upon her husband's death. Such is the case because in the context of a divorce proceeding – it is immaterial how an asset is titled; the court will determine the true ownership of an asset. However, in determining a decedent's probate estate, title is determinative of ownership. Thus, even if property titled in the name of the deceased spouse is actually marital property, that spouse can nonetheless pass that property to a third party by way of a nonprobate transfer and successfully defeat the surviving spouse's rights in that property. It is not hard to see where a situation can very well arise in Ohio where a spouse is better off obtaining a divorce than risking disinheritance.

The two controlling cases in Ohio are *Smyth v. Cleveland Trust*[1] and *Dumas v. Estate of Dumas*.[2] The Ohio Supreme Court determined in *Smyth*, that where a decedent transferred assets to an inter vivos trust, those assets were beyond the reach of the surviving spouse, as that spouse's rights after the decedent's death extended only to probate assets. The Court reaffirmed their position in *Dumas*.

The Proposed Law

The proposed legislation expands the surviving spouse's rights beyond the decedent's probate estate, establishing the "augmented estate." Once the augmented estate is identified, a determination is made as to what portion of the "augmented estate" constitutes marital property. The proposed statutes specifically provide that the entire augmented estate is presumed to be marital property unless proven to be separate property by a preponderance of the evidence.

In determining what constitutes marital property, the proposed statutes make specific reference to R.C. § 3105.171, the statute used in divorce proceedings that defines marital property and separate property. Essentially, that statute provides that "marital property" means all real and personal property owned by either or both of the spouses that was acquired by either or both of the them during the marriage.[3] It also includes the income and appreciation on separate property that is due to the labor, monetary or in-kind contribution of either or both spouses that occurred during the marriage.[4] However, marital property does not include "separate property."[5] "Separate property" consists of inheritances of one spouse, property each spouse brought into the marriage, passive income and appreciation on separate property, property excluded by an antenuptial agreement, personal injury proceeds and gifts made to one spouse.[6] As David Allen has pointed out, estate and trust attorneys may need to consult a family law practitioner to help them identify marital and separate property.[7]

Under the proposed legislation, a surviving spouse may elect to take fifty percent of the marital property. That amount is reduced by that portion of the decedent's augmented estate the surviving spouse already owns or that passes to her upon the decedent's death.[8]

Why Ohio Needs this Law

Most married couples plan their estate in such a way so as to provide primarily for the other[9] and to take advantage of estate tax saving techniques. This is particularly true of couples who have children in common and have not been previously married. However, where there are children from prior marriages, the focus often changes from providing for one's spouse to ensuring an inheritance for one's children. Where a decedent, through nonprobate transfers, disinherits his spouse and leaves all of the marital assets to his children, the result is, more often than not, most unfair.

The *Dumas* case illustrates the need for this law. Mr. and Mrs. Dumas were married for twenty-six years. They had no children in common but both had children from prior marriages. In 1985, Mrs. Dumas established a trust with her separate assets worth $360,000 for the benefit of herself and her daughter. Mr. Dumas had suggested she establish this trust because of the litigious nature of their business ventures. In 1986, Mr. Dumas transferred marital assets worth approximately $450,000 to his revocable inter vivos trust. In 1987 Mrs. Dumas left him and filed for divorce in 1988. Nine days later Mr. Dumas died. His inter vivos trust named his two daughters from a prior marriage as the sole beneficiaries; excluding Mrs. Dumas entirely. Mrs. Dumas claimed that Mr. Dumas's transfer of assets to his trust constituted a fraudulent conveyance. The Ohio Supreme Court disagreed and, relying upon *Smyth*, held that a valid nontestamentary trust executed by a settlor and in existence at the time of his death bars the settlor's surviving spouse from claiming a distributive share in the trust assets.

Justice Alice Robie Resnick vigorously dissented arguing that the fact that the decedent's property passed under an inter vivos trust, as opposed to passing under a will, should not prohibit the surviving spouse from exercising her right of election. Further, if Mr. Dumas had not died before the divorce proceeding was completed, Mrs. Dumas could have reached those trust assets -- assets that were beyond her reach the moment of his death. In closing, Justice Resnick stated, "Today's courts should not, as the majority does, condone absolutely any attempt by one spouse to disinherit another through a revocable trust funded with marital property."[10]

The Supreme Court in *Dumas* apparently felt its hands were tied because of its decision in *Smyth*. However, the facts in *Smyth* are significantly different from those in *Dumas*. Nearing the age of retirement, Mr. Smyth decided to establish a revocable inter vivos trust. He advised his wife of his plan and she accompanied him to the bank to establish it. The trust provided that upon Mr. Smyth's death, Mrs. Smyth was entitled to all of the net income from the trust as well as discretionary principal. In Mr. Smyth's words it was his desire, "that my wife be amply and comfortably provided for at all times."[11] Upon Mrs. Smyth's death the trust was to be distributed to their only child. Should their only child fail to survive the two of them the trust was to be held for the benefit of their daughter-in-law during her lifetime for subsequent distribution to their grandchildren. Five years after establishing the trust, Mr. Smyth died. At the time of his death, the trust was worth $136,135.37. In addition to her interest in the trust, Ms. Smyth received outright distributions of nonprobate assets worth $37,748.47. The case does not specifically state that the assets in Mr. Smyth's revocable inter vivos trust were marital but one can certainly infer as much since the court mentions that Mr. Smyth was a businessman who according to Mrs. Smyth, "'wanted to fix things so that I wouldn't have any bother and trouble about it.'"[12] Also, it would appear that this was the first marriage for both and neither had any other children.

These facts are diametrically opposed to those in *Dumas*. Mrs. Smyth was well provided for by her husband; Mrs. Dumas was completely disinherited. The fact that both cases concerned revocable inter vivos trusts is just about the only thing they have in common. Instead of focusing on the fact that an inter vivos trust is nonprobate property, the court in *Dumas* should have concerned itself with the fact Mr. Dumas' trust held marital assets and provided Mrs. Dumas with no benefit. Fortunately, the proposed legislation rectifies this and provides for a determination of the nature of the assets (marital or separate) transferred to an inter vivos trust and for an examination of the benefits the trust provides for the surviving spouse.

How Would Mrs. Smyth and Mrs. Dumas Fare Under the Proposed Statutes?

Under the proposed legislation Mrs. Smyth would not derive any benefit. First, because she was entitled to income for life from Mr. Smyth's trust, she would be deemed to have had received at least fifty percent of the property in the trust under the proposed statutes. The only other

marital asset of the Smyth's appears to be $37,748.47 worth of assets that passed outright to her. Thus, Mrs. Smyth would not choose to exercise her rights of election under the proposed statutes because she would not be entitled to any additional property.

On the other hand, because she had no interest in her husband's trust whatsoever, Mrs. Dumas would have been entitled to an outright distribution of one-half of Mr. Dumas's trust valued at $450,000 or $225,000 (50% of $450,000). This of course assumes that Mrs. Dumas would have been able to prove by a preponderance of the evidence that her trust valued at $360,000 did indeed consist of her separate property. Otherwise, that property would become part of the marital assets subject to a fifty percent division thereby reducing her interest in Mr. Dumas' trust to $45,000 (50% of ($450,000 plus $360,000) less $360,000).[13]

The proposed legislation is for Mrs. Dumas, not for Mrs. Smyth. And rightly so, Mrs. Smyth was adequately provided for -- probably the reason the Supreme Court decided her elective rights did not extend to Mr. Smyth's trust. The broad principles of law set forth in *Smyth* have been interpreted (and arguably misapplied) to allow a spouse to disinherit his spouse completely. That is what makes Mrs. Dumas' case so compelling -- the Supreme Court denied Mrs. Dumas her rights in the marital assets.

The Status of the Proposed Law

The proposed legislation has undergone significant modifications and its metamorphosis has been chronicled over the years in the Probate Law Journal of Ohio.[14] Estate planners once critical of the proposed law have now begun to accept it; although it is now in a much different form than it once was.

With the criticisms addressed, it appears that the proposed statute will soon become law in Ohio. As this article goes to press, two new issues have arisen that have not been discussed in the Probate Law Journal of Ohio and have not yet been added to the bill.

The first issue is whether, under the statutes as proposed, a deceased spouse would receive credit for giving his spouse his separate property. In other words, if the decedent left all of his separate property to his wife but left her no marital property, would she receive all of his separate property as well as fifty percent of the marital property? It appeared that this may have initially been the case. The Committee on Statutory Share of Surviving Spouse did not consider this a favorable outcome and have suggested a change to the proposed legislation that would provide that any separate property left to a surviving spouse will be counted toward fulfilling her elective share. This outcome certainly provides greater flexibility in estate planning since marital as well as separate property of a decedent can be used to satisfy the surviving spouse's elective share.

The second issue that has recently arisen concerns the surviving spouse's elective share rights to property in a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT). The IRS has recently provided a safe harbor procedure under which it will disregard a surviving spouse's right of election for purposes of determining whether a CRAT or a CRUT is valid.[15] The revenue procedure provides that if under state law, a surviving spouse has a right of election exercisable on the grantor's death to receive an elective share of the grantor's estate that can be satisfied from assets of the CRAT or CRUT, the CRAT or CRUT fails to qualify because an amount other than the annuity or unitrust payments could be paid to a person other than a qualified organization. The surviving spouse must irrevocably waive the right of election to the extent necessary to ensure that no part of the trust (other than the annuity or unitrust interest of which the surviving spouse is the named recipient) may be used to satisfy the elective share. Accordingly, the Committee on Statutory Share of Surviving Spouse is working on an amendment to the proposed statute that will provide for a waiver to be executed by a surviving spouse to all property in a CRAT or CRUT.

Conclusion

The proposed legislation to expand the rights of the surviving spouse in Ohio is an idea whose time has come. Although it may have taken over a decade to reach this point, along the way concerns and criticisms of estate planners have been addressed and resolved. Ultimately, this new law will provide a safety net for surviving spouses who have been unfairly deprived of their share of the marital assets. Practitioners should not be discouraged; for most married couples who leave their assets to each other either in trust or outright, the proposed law is irrelevant. And although the proposed new law may be complex, for the spouse who has been deprived of her share of the marital assets, it is well worth it.❖

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[1] *Smyth v. Cleveland Trust*, 2 Ohio St. 489 179 N.E.2d 60 (1961).

[2] *Dumas v. Estate of Dumas*, 68 Ohio St.3d 405, 627 N.E.2d 978 (1994).

[3] R.C. § 3105.171(A)(3)(a).

[4] R.C. § 3105.171(A)(3)(a)(iii).

[5] R.C. § 3105.171(A)(3)(b).

[6] R.C. § 3105.171(A)(6)(a).

[7] Allen, *Elective Share 2004*, 14 PLJO 134, 138 (July/Aug. 2004).

[8] Query, does this mean that the surviving spouse's separate property will be used to satisfy the share of the marital property to which the surviving spouse is entitled? It can be argued that the proposed statute, in its current form, provides for this outcome. Thus, for example, if at the time of the decedent's death there is $100,000 in marital property in the decedent's name and the surviving spouse has $50,000 of separate property, she would not be entitled to anything if she exercised her elective share rights. This is because as the surviving spouse she would be entitled to $50,000 in marital property (50% of $100,000) and if, as the proposed statute suggests, her separate property is to be used to reduce this share, she would be entitled to nothing ($50,000 less $50,000 is zero). It is this author's understanding that such a result is not intended and language will be added to the proposed statutes to clarify that a surviving spouse's separate property will not be an offset against the elective share.

[9] Bright and Weiler, *Ohio Spouse's Right of Election and Augmented Estate*, 13 PLJO 87, 90 (Mar./Apr. 2003) citing Newman, *Incorporating the Partnership Theory of Marriage into Elective-Share Law: The Approximation System of the Uniform Probate Code and the Deferred-Community-Property Alternative*, 49 Emory Law Journal 487, footnote 16, at 538 (Spring 2000).

[10] *Dumas v. Estate of Dumas*, 68 Ohio St.3d 405, 414, 627 N.E.2d 978, 985 (1994).

[11] *Smyth* at 491, 179 N.E.2d 60, 62.

[12] *Smyth* at 502, 179 N.E.2d 60,79.

[13] If, however, the proposed statutes are interpreted to provide that the surviving spouse's separate property reduces her share of the marital property, then Mrs. Dumas would not benefit from exercising her rights to the elective share. (50% of $450,000 (the marital assets) equals $225,000 less $360,000 (her separate property) is less than zero).

[14] Allen, *Does Ohio Need Uniform Probate Code Solutions for the Surviving Spouse's Intestate and Forced Share Rights?*, 3 PLJO 8 (Sept./Oct. 1992); Allen, *Spousal Rights on Death - Ohio Needs Change*, 6 PLJO 1 (Sept./Oct. 1995); Bright and Weiler, *Revised Spousal Rights Under Ohio S.B. 95 and Where is My Grandfather?*, 8 PLJO 3 (Sept./Oct. 1997); Allen, *Ohio Needs Uniform Probate Code Article II*, 13 PLJO 81 (Mar./Apr. 2003); Bright and Weiler, *Ohio Spouse's Right of Election and Augmented Estate*, 13 PLJO 87 (Mar./Apr. 2003); Allen, *Elective Share 2004*, 14 PLJO 134 (July/Aug. 2004).

[15] Rev. Proc. 2005-24 to be published in I.R.B. 2005-16 April 18, 2005.