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## **HOW TO PROTECT GIFTS AND INHERITANCES WHEN A DIVORCE HAPPENS**

Often when working with clients on estate planning matters, they have a concern when their children inherit property what will happen to that family property if the child gets a divorce. Although I have never practiced divorce law and do not give advice in regard to divorce situations, it is good to know the fundamental differences between "marital property" and "separate property." In summary, marital property consists of all real and personal property acquired by either or both spouses during the course of the marriage. Separate property is property acquired by a spouse at any time by gift, bequest, devise, or dissent. Property acquired prior to a final hearing on a divorce that is traceable to separate property constitutes separate property, unless it has been gifted to the marital estate or has been transmuted into marital property through commingling with marital assets. Therein lies the problem. When has separate property been transmuted into marital property through commingling with marital assets? The recent case of Church v. Church decided by the Tennessee Court Of Appeals provides some guidance in determining this fact. In the Church case, the wife was a child of a prominent business man who owned several automobile dealerships around Franklin, Tennessee. Mrs. Church's parents developed a plan of interrelated transactions over the course of more than a decade. The parents' estate plan involved stock purchase agreements and promissory notes from their children (which included Mrs. Church) for stock in automobile dealerships.

After a "family falling out," Mrs. Church sold her interest in the family automobile dealerships and real estate holdings back to her father for a total of \$2,000,000.00 and forgiveness of certain debts. Three months after this transaction between Mrs. Church and her father, she filed for a divorce. The key issue in the divorce was whether the \$2,000,000.00 for the family automobile dealerships and real estate holdings was marital property or separate property.

The Trial Court found that Mrs. Church acquired her interest by gift and therefore classified the proceeds from the sale to her father as separate property. This decision was affirmed by the Court Of Appeals. The Court Of Appeals relied on the testimony of the financial planning attorney and Mrs. Church's brother that the transfers were intended to be gifts. The Court Of Appeals pointed out that a review of recent case law revealed that the failure to file a Federal Gift Tax Return is relevant to but not dispositive of the question of whether the property at issue was acquired by gift. The structure of the transaction in Church dealt with the equitable distribution statute for divorce, not gift taxes.

**MY RECOMMENDATION:** In the Church case, substance ruled over form. However, some might consider Mrs. Church lucky because the gifts were attempted to be disguised as business transactions.

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This letter is intended to provide you with ideas for consideration in estate planning business. It is not intended to give a general solution applicable to all apparently similar individual problems, since slight changes in facts may require variance in legal advice. Please contact legal counsel with specific questions.