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Maryland Enacts New Elective Share Law

Increased life insurance planning opportunities for states that have adopted the augmented estate concept.

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Derived from a statute originally enacted in 1798, Maryland's elective share law is fundamentally changing in 2020. No longer limited to a fractional share of the net probate estate, a surviving spouse who rejects what was given to her under her late husband's existing estate plan will receive her elective share out of the decedent's augmented estate. Md. Code, Est. & Trusts Section 3-404(b)(10) (2019) provides that the

augmented estate includes life insurance proceeds payable to a non-spousal beneficiary, outright or in trust, unless the policy was purchased either before marriage or five years before death, or the spouse otherwise consents. Several planning opportunities with life insurance are possible under Maryland's new law and may also be of interest in the 21 states that have adopted the augmented estate concept. Virginia and West Virginia are among the 13 states that calculate their elective shares based on an augmented estate model substantially similar to a version of the Uniform Probate Code. Eight other states, including Delaware, Florida, New York and Pennsylvania, have adopted a modified form of the augmented estate.

Overview of Elective Share Law

Under Maryland's existing law, the surviving spouse may reject provisions under the decedent's last will and testament and elect to take from the net probate estate: (1) a one-third share when the decedent has surviving issue, or (2) a one-half share when no issue survives. Any beneficiary's rights in non-probate assets, *inter vivos* transfers to trusts or outright gifts are unaffected by the spouse's exercise of elective share rights, absent proof of fraud. (See Allan J. Gibber, *Gibber on Estate Administration* Section 10.31 (6th ed. 2018)). While a surviving spouse who exercises her right of election beginning Oct. 1, 2020 will receive the same fractional share as under existing law, a key difference is that "the estate subject to election" will start with the concept of the augmented estate. This consists of: (1) the decedent's probate estate; (2) the decedent's revocable trusts; (3) property with respect to which the decedent, immediately before death, held a qualifying power of disposition; (4) the decedent's qualifying joint interests; (5) the decedent's qualifying lifetime transfers; and (6) certain life insurance policies. The augmented estate is reduced by: (1) expenses and claims; (2) trust assets; (3) joint interests, lifetime transfers and property in which a decedent had a qualifying power of disposition to which the surviving spouse consented during lifetime; (4) irrevocable transfers; (5) life estates; and (6) spousal benefits. As under existing law, the new law requires a signed writing filed in the appropriate court and follows the

same time frames for making an election, withdrawing the election and granting an extension. (Md. Code, Est. & Trusts Sections 3-403, 3-404, 3-407, 3-408, 3-409, 3-206, 3-207 (2019)).

Undesirable Consequences with Blended Families

One goal of an elective share statute may be to safeguard the surviving spouse from disinheritance by a conniving mate. Three Maryland, New York and New Jersey cases, in which a court barred a widow's elective share claim, demonstrate that the deceased spouse's children from a prior marriage are sometimes the parties in need of protection. See *In re Watkins*, 209 A.3d 135 (Md. Ct. Spec. App. 2019) (third wife dominated the decedent, physically attacked him when he initially declined to marry her and isolated him from his daughter and friends); *Campbell v. Thomas*, 73 A.D.3d 103 (2d Dept. 2010) (substitute caregiver secretly married a man suffering from dementia while his daughter (his regular caregiver) was on vacation, moved her husband's assets into her name and changed his pension's beneficiary designation); *Chrisomalis v. Chrisomalis*, 615 A.2d 266 (1992) (widow attempted to set aside valid antenuptial agreement protecting her husband's estate and his sons' interest in family business and openly admitted her intention not to be bound by it). Although a spouse's attempt to take undue advantage isn't unique to Maryland's new law, calculating the elective share based on a larger pool of the decedent's assets could exacerbate the result and provide more incentives for unsavory behavior.

Planning Strategies with Life Insurance

Because the new law may allow a surviving spouse to share in the death benefit of a life insurance policy intended for another beneficiary, the following strategies may incentivize a spouse to refrain from exercising the election and thus protect legitimate non-spousal beneficiaries.

Scenario 1: Angus and Simone are married. Angus purchased a whole life (WL) insurance policy on his life with a charity as beneficiary. If

Angus dies within five years of purchasing this policy, Simone may elect to have a share of the death benefit proceeds, less the cash surrender value, included as part of her spousal share. Should Angus predecease Simone, Angus doesn't wish to have his charitable planning disrupted. Simone could agree in writing to forgo an election, but Angus fears the new law could be modified to prevent such a refusal. Md. Code, Est. & Trusts Section 3-406 (2019) says that waiver of the right of election may be made through a pre-marital or post-marital agreement or written waiver.

Solution 1— Purchase Term Life Insurance: Angus purchases a term policy on his life in an amount equal to the WL policy and names the same charity as beneficiary. Should Angus die within five years and Simone makes an election under the new law under both policies, the combined remaining death benefit proceeds from both policies would satisfy Angus's charitable wishes.

Scenario 2: Jared and Emma have been married for five years, and each have minor children from previous relationships. They want to ensure financial security for their surviving spouses and surviving children and that an election by a surviving spouse under the new law doesn't upend those plans. During their marriage, Jared and Emma wish to use the entirety of their joint assets.

Solution 2— Plan Separately for Beneficiaries: Jared and Emma each form a spousal lifetime access trust (SLAT) for the benefit of the other, to which each spouse gifts up to their maximum lifetime exemption amount (up to \$11.58 million in 2020). While each spouse is living, he or she benefits from distributions made to the other spouse that may be used for their joint vacations, housing expenses and financial commitments. If each SLAT holds a life insurance policy on the grantor spouse, at the death of the grantor spouse, the death benefit proceeds can replace the loss of the beneficiary spouse's indirect access to the SLAT and satisfy the surviving spouse's elective share under the new law.

At the death of the non-grantor spouse, the trust will distribute the remainder of its assets under the SLAT to other beneficiaries. The SLATs should have different terms and beneficiaries. Otherwise, pursuant to Internal Revenue Code Section (a)(1) and *U.S. v. Grace et al.*, 395 U.S. 316 (1969), trusts created by each spouse for the other with substantially identical provisions and that put each grantor in approximately the same economic position as if he or she had retained a life estate in the other's trust are considered to be reciprocal trusts and would be includible in the other grantor's gross estate at death.

Scenario 3: Martha is separated from her husband, Terrence. They have three children. As Martha and Terrence are still legally married, Martha fears she's going to lose a lot of her estate she intends for her children to Terrence if Martha predeceases him. Further, Terrence won't consent in writing to forgo an election.

Solution 3- Purchase Policy to fund Elective Share: Martha establishes an irrevocable life insurance trust (ILIT) for the benefit of Terrence, which is owner and beneficiary of a life insurance policy on Martha's life. The death benefit is an amount to satisfy the value of Martha's estate subject to any election Terrence would likely make under the new law.

The trustee should be granted powers to manage the policy in case the policy is no longer needed. For example, under IRC Section 675(4), the trustee could allow Martha as the grantor to substitute another asset for an equivalent value in exchange for the policy. The policy could then be used to fund another ILIT. The trustee could also donate the policy for a charitable tax deduction.

Review Existing Estate Plans

Maryland's new law affects many property interests through a complex system for satisfaction of a spouse's elective share and provides an incentive for married individuals to review their existing estate plans.

Such a review is important to: (1) ensure that each spouse has made adequate provision for the other; (2) address factors which may motivate a surviving spouse to exercise the right to an election; and (3) protect legitimate plans for a decedent's children and transfers to non-spousal beneficiaries. While a decedent's heirs may request judicial review and modification of the spouse's elective share or the property to which it applies, planning ahead to address potential family conflicts is nearly always preferable to judicial intervention.

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