

Estate Planning for Blended Families



Introduction

The number of blended families in Canada is on the rise. Blended families are those in which one or both spouses bring with them children from a previous relationship. These children may be young at the time that the new relationship begins, or they may already be independent adults. In either case, blended families have unique dynamics which can add complexity to a person's estate and which may require more in-depth planning.

A note on terminology: For convenience, the term “spouse” will be used throughout this article to refer to both common law and married spouses, unless specified otherwise.

Unique considerations for blended families

While each blended family is distinct in their own way, there are several common concerns which tend to arise. .

1. Competing support obligations

Canadian estate law generally permits an individual to gift their estate to whomever they wish. One important exception to this rule arises where a person owes an obligation to financially support another individual, such as a spouse or child. In blended family situations, there may be a court order or separation agreement requiring ongoing spousal or child support which will continue even if the payor dies. Additionally, a financially dependent spouse, child or other family member may have the right to claim support from the deceased's estate if the deceased did not leave them adequate funds.

Issues arise where an individual's estate wishes do not accord with their support requirements. For example, an individual who wishes to leave their entire estate to their children from a first marriage may nonetheless have a legal obligation to support their second spouse. It is important to note that the law around support obligations, and who may qualify as a dependent, varies significantly between provinces.

2. Spousal property rights

In addition to potential support rights, a spouse may have property rights which entitle them to a portion of their deceased's spouse's estate. In Ontario, for example, married spouses may elect to take an equalization payment from their deceased's spouse's estate as though the spouses had separated on the date of death, if this will result in them receiving more than they otherwise would have from the estate. Ontario family law will determine the amount which the surviving spouse is owed. This same right does not extend to common law spouses in Ontario.

As with support obligations, the law concerning spousal property rights on death varies significantly between provinces.

3. Inconsistent legacy plans

In traditional family situations, spouses generally agree on how they want their estate to be divided. Typically, spouses will leave everything to each other, and then divided among the children. They may choose to leave gifts to other individuals or charities, particularly where there are no children, but their wishes for where their assets ultimately are gifted tend to align. In blended family situations, spouses may enter the relationship with a degree of financial wealth and with children from previous relationships. This generally leads each partner to want to leave their estate in a manner that does not align with the other partner and a more common view of “what’s mine is mine” rather than “what’s mine is ours”. This complication can be further exacerbated where there are jointly-owned assets, which will legally pass to the surviving spouse on the first spouse’s death. For such assets, the spouse who passes away first will have no ability to direct to whom the asset is passed on after the second spouse’s death.

4. Family conflict or mistrust

While family conflict is always a potential concern in estate planning, this concern can be more prominent in blended family situations. Wishes and expectations regarding family funds are not always aligned among family members, and competing interests can cause significant discord.

Tools for estate planning in blended family situations

There are several estate planning tools which may be particularly valuable in blended family situations.

1. Mutual Wills

In a traditional family situation, spouses typically execute wills that mirror each other’s, both leaving everything to each other first and then to their children after both have passed. Each spouse trusts the other that even after they have passed, the surviving spouse will not remove their children from the will. In blended family situations, spouses may also wish to create mirroring wills, but may be concerned about the possibility that the surviving spouse will amend their will after the first spouse’s passing.

One possible solution is to draft mutual wills, which includes both mirroring wills and a signed agreement which restricts the spouses from amending their wills without the other’s consent. The agreement will prohibit the surviving spouse from amending their will after the first spouse’s passing. Typically, the surviving spouse is also prohibited from depleting the estate through gifting prior to death.

Mutual wills do have some drawbacks. First, if the surviving spouse does amend their will, this new will is considered legally valid and any beneficiaries whose inheritance was reduced or eliminated will need to bring a claim to court in order to recover. In this respect, use of a trust may be a preferred strategy. Another concern is that there may be legitimate circumstances after a spouse’s passing which would require changes to the will, but such changes would no longer be possible.

2. Use of Trusts

Trusts are legal structures which allow a person to leave assets for the benefit of an individual while leaving someone else – the trustee – in control of these assets. Trusts can have terms which dictate how the trustee may manage and pay out trust assets or can leave such decisions entirely to the trustee. Trusts can also be established and funded during an individual's lifetime (inter vivos trusts) or on death (testamentary trusts).

Trusts are an excellent way of balancing out competing rights and needs in estate planning. They are also useful tools for ensuring that inherited funds are protected for many years or even multiple generations.

Certain trusts, such as spousal trusts, are commonly used in blended family situations. With a spousal trust, the spouse of the deceased will have the benefit of all of the income of the trust, with potential access to the capital if desired. However, after the spouse passes, the trust terms will dictate to whom the remaining trust assets should pass. Therefore, an individual can both provide for their spouse during the spouse's lifetime while still ensuring that their children or their favourite charities obtain the final gift. Spousal trusts have unique tax treatment that can also make them appealing.

In order for assets to be directed into a trust upon a person's death, they must solely own the asset. Often, spouses own assets jointly, which means that the asset will pass directly to the surviving spouse and not into any trust set up through the deceased's will. To protect the ultimate distribution of these assets, spouses may consider establishing a joint partner trust, which is set up and funded during the spouses' lifetime, instead of on death.

3. Professional and neutral executor and trustee

When estate planning for blended families, it is particularly important to pay special attention to the issue of who will be appointed as the executor and trustee. Naming either the second spouse or a child as the executor can lead to feelings of mistrust and resentment from the other party. Conversely, appointing both a spouse and child(ren) jointly can lead to disagreements which may stall the estate administration. At best, such situations will lead to increased tension and at worst they can lead to lengthy litigation.

Because of this concern and because blended family situations generally lead to more estate complexity, a professional and neutral executor and trustee is often a highly recommended part of a well-executed estate plan.

First, a professional executor will remain objective in the administration of the estate and any trusts. A professional executor is generally immune from acting in a self-serving manner because they do not inherit from the estate and they do not have a history of complex emotions with any of the beneficiaries. Appointing a professional executor will ensure that the will and other estate documents are properly followed and that a full record of all estate assets and transactions is kept and routinely provided to the beneficiaries. This can significantly reduce any potential for conflict between family members and can provide comfort to family members, who are assured that the estate assets are being well managed.

A professional executor is also best placed to deal with the complexities of the estate assets, family situation, and competing legal obligations. Finally, if there are one or more trusts established as part of the estate plan, such as spousal trusts, a professional executor will again ensure that the trusts are being managed properly and that the interests of all beneficiaries are protected.

Engaging the services of a trust company to act as executor and trustee can prove to be an integral part of a well-crafted estate plan in blended family situations.

4. Life insurance

Life insurance can be an excellent tool to assist in accomplishing all of a person's estate planning needs in a blended family situation. For example, life insurance can help to secure a court-ordered support obligation to an ex-spouse. Leaving sufficient life insurance directly to the ex-spouse can ensure that the spouse has no further claims against the estate.

Life insurance can also be a way to maximize the estate in order to make sure that there are sufficient funds both to provide for a current spouse and to make a desired bequest to children from a first marriage.

Life insurance has a few additional benefits, as long as it is structured properly. First, life insurance is paid out tax-free and can by-pass probate if there are one or more direct beneficiaries named. Secondly, life insurance can be structured so as to provide a secret gift where the deceased does not want some family members concerning themselves with the amount left to another.

5. Cohabitation or marriage contracts

A well-drafted cohabitation or marriage contract can help to clarify and restrict spouses' entitlements to share in each other's estates. For example, spouses may agree that neither one is entitled to spousal support or to limit any potential family property claims. It is important to work with a qualified lawyer to draft these documents and provide legal advice. Some rights cannot be limited by contract. In other circumstances, a contract can be amended or overturned by a judge. Here too the laws vary significantly between provinces. Still, proper use of a cohabitation or marriage contract may form an essential part of a proper estate plan in blended family situations.

A Note on Tax and Probate Planning

Reducing taxes and probate fees is a common and valid concern for individuals in planning their estates. Unfortunately, the most advantageous tax and probate planning techniques can sometimes be at odds with the most advantageous techniques to protect the estate assets and family harmony. For example, transferring an RRSP or RRIF account to a spouse on death can result in a tax deferral on these funds which is not available if they are transferred into a trust. However, a trust can ensure that the assets are preserved for the next generation, while control over the assets is lost with a direct transferal to a spouse. An effective estate planner will seek to reduce taxes and probate fees wherever possible without risking the overall effectiveness of the estate plan.

Conclusion

Estate planning and administration is becoming increasingly complex, and the increase of blended families is one of the reasons for this trend. Working with an estates professional to recognize and resolve any potential issues in the estate plan has never been more important. For more information, and to learn about options available to you in planning your estate, reach out to your investment advisor



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