EXPERT SERIES

IG WEALTH MANAGEMENT

# Estate planning for blended families

Estate planning for blended families in common-law jurisdictions[1] brings many scenarios—and can be complex. Challenging situations can be avoided by first considering everyone's interests and needs in the structure of your plan.

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01 A blended family is where some or all of the children are not the natural or adopted children of both spouses or common-law partners.

02 A standard will may not be appropriate if you want to ensure that children of both spouses receive part of the combined estates.

03 Possible options include spouse or common-law partner trusts, dividing the assets between the spouse and children, and using life insurance to satisfy all beneficiaries.

Blended families are families where some or all of the children in the family are not the natural or adopted children of both spouses (the definition of "spouse" including common-law partners). Even though blended families may be common place, it does not mean that the estate planning process is straightforward for them. Determining how an estate should be structured is more complicated since there are competing interests between the new spouse and any children from a previous relationship. Many blended families do not structure their estate plan properly, with the result in many cases being that one branch of the family receives the entire estate, with the other branch of the family receiving little or nothing.

How can this happen? The main reason is because many individuals don't customize their estate plan properly and attempt to make things "simple" by placing all their assets in joint ownership with their spouse with a right of survivorship, or designating their spouse as the direct beneficiary of their Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), Tax-Free Savings Accounts (TFSAs) and insurance. The other problem is the use of "standard" wills, which usually indicate that upon the death of the first spouse, everything is to go to the survivor. Determining how an estate should be structured is more complicated since there may be competing interests between the new spouse and any children from a previous relationship.

Let's look at a case study. In our scenario, Pierre and Melissa are married, each having children from a previous relationship. They hold their home and non-registered investments in joint names, and have designated each other as the direct beneficiary of their insurance policies, TFSAs and RRSPs. Here are a few of the possible outcomes:

[1] The information in this article is relevant for Canadian provinces and territories other than Québec. Clients should always confer with an experienced family lawyer in their jurisdiction to understand the rules that apply to their specific situation.

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- If Pierre dies first, then Melissa will inherit everything, regardless of the terms of Pierre's will, since nothing went through his estate. Even if Melissa has a will that indicates that everything is to be divided among her "children" or "issue", Pierre's children will still be disinherited, since those terms would be interpreted to include only natural or adopted children, not step-children. If both Pierre and Melissa's children are to be included in the division of the combined estate upon the death of the surviving spouse, then they need to be listed by name in the will, or otherwise specifically contemplated by including "the issue of my spouse" or other such wording.
- Even if Pierre and Melissa sign wills which specifically contemplate all of their children, if Pierre leaves everything to Melissa, and Melissa remarries, her previous will may be rendered void in the event she re-marries, depending upon which jurisdiction she lives in (marriage does not render wills void in all jurisdictions).
- If Melissa does not sign a new will after she remarries and she lives in a jurisdiction where marriage revokes all previous wills, she will effectively die intestate, meaning that all of her assets will go to her new spouse and children only, since intestate succession legislation does not include step-children (i.e. Pierre's children).
- Even if Melissa does sign a new will that specifically contemplates Pierre's children, Melissa's new spouse could still have a first claim against a portion (or all) of the estate. In the more common scenario where Melissa fails to specifically include Pierre's children, it is very likely that Pierre's children will not receive any of the estate.
- Another possibility is that Melissa could choose to give away her assets to her children or re-write her will. If you want the survivor to be bound by the original wills, then you should sign a contract agreeing not to change your wills (or change the ultimate distribution scheme in any later will) after the death of the first spouse. Without an agreement to this effect, it is possible that a court may not agree that the original will is still binding.
- Even if you sign wills that specifically contemplate all of your children, and also sign a contract agreeing not to change your will, there are still a number of ways in which children could be disinherited. One of the most common methods is when individuals decide to do "probate planning" by placing all their assets in joint ownership, or by designating their spouse as the direct beneficiary of their registered investments and insurance policies. So, for example, Melissa could remarry and then structure her affairs so that her new spouse receives everything outside of her estate, effectively leaving nothing in her estate to give to Pierre's children.

From the above, it is evident that the spouse who dies first will not have any control over whether or not their children will receive any part of their estate if they leave everything directly to the survivor. In many cases, the surviving spouse does not choose to disinherit their step-children, but it has still happened inadvertently. If you want to ensure that the children of both spouses will receive part of the combined estates, it may not be appropriate to use standard wills. Here are some possible options.

### (I) SPOUSE OR COMMON-LAW PARTNER TRUSTS

One strategy that individuals in blended families often ask about is a spouse or common-law partner trust. The general concept with a spouse trust is that the surviving spouse would be entitled to use the estate assets during his or her lifetime, and the children of the previous relationship will be entitled to them upon the death of the spouse. If a spouse trust is used, then upon the death of the second spouse, the capital in the trust will be distributed according to the will of the spouse who died first, not according to the will of the survivor. This is because the assets never become the property of the surviving spouse – the assets are the property of the spouse trust, and therefore can be distributed to the children of the first spouse after the second spouse dies, even if the second spouse remarries, and even if he or she changes his or her will. However, if the trust is not drafted in accordance with the provisions of the *Income Tax Act*, there could be a tax liability upon the death of the first spouse, which is why it is crucial that you speak to an experienced estate lawyer if you choose to go this route.

Another way in which the strategy may fail is if all aspects of the estate plan do not work in concert. For example, if you have arranged your affairs so that none, or very few of your assets will pass through your estate, this type of planning will be ineffective. Many couples often hold title to their assets in joint names so that they will pass to the survivor automatically. If the assets pass directly to the surviving spouse, then they will not be subject to the conditions set out in the will. In many blended family scenarios, it may not be recommended that assets be held jointly, or that spouses be named as direct beneficiaries on registered assets (such as RRSPs, RRIFs or TFSAs) or insurance policies.

> *Another consideration is that the items which are of most importance to children from previous relationships are often family mementos and heirlooms.*

However, there are many instances where using a spouse trust may not be recommended or practical. Consider the following:

- If the new spouse is close in age to the children of the previous relationship, it is quite possible that the children will not receive any part of the capital during their lifetime, since the children will only be entitled to receive the trust capital upon the death of the surviving spouse.
- If you feel that your surviving spouse and children will not be able to co-operate after the time of your death, a spouse trust may not be practical. If your spouse and children are not likely to agree on the degree to which your spouse may encroach upon the capital of the trust, this could lead to protracted arguments, and potentially, litigation.
- Spouse trusts can become contentious because the life tenant (i.e. the surviving spouse) will be liable for paying ongoing maintenance costs whereas the capital beneficiaries (i.e. the children from a previous relationship) will be liable for paying costs related to capital improvements. If the children or spouse are not in a position to carry these costs long term, disputes may arise.

### (II) DIVIDING THE ASSETS BETWEEN THE SPOUSE AND CHILDREN

Although many people in blended families believe that using a trust is the best strategy, in fact, it is often not recommended due to the limitations previously discussed. So what are the alternatives?

One option that may be available to individuals who have significant assets is to leave a portion of their estate directly to their spouse, and leave different assets directly to their children. However, this is sometimes more difficult to do than people realize, primarily due to the fact that a surviving spouse may have rights under various provincial statutes, including the ability to make an application for dependant's relief (or wills variation, if you live in British Columbia) or an application for a division or equalization of family property. In fact, it is relatively difficult to disinherit a spouse, which is why it is important to ensure that your will is properly structured, and to the extent possible, your spouse should waive any rights they may have to challenge the distribution of your estate. This type of planning should not be undertaken without the assistance of a lawyer who has extensive estate planning experience.

One other complication that needs to be considered when assets are left to persons other than the surviving spouse is the tax liability that can arise from that. Generally speaking, when assets are left to surviving spouses, they will "roll over" for tax purposes. However, if assets are left to children from a previous relationship, that could trigger a deemed disposition of any unrealized capital gain. In addition, registered investments left to children will usually become taxable immediately (except in very limited circumstances). A tax professional can help you determine the most tax effective method for distributing your assets.

*Estate planning for blended families can become quite complex — Speak to your IG Consultant to ensure your estate is structured in a way that considers the interests of both your new spouse and your children.*

Another consideration is that the items which are of most importance to children from previous relationships are often family mementos and heirlooms. You should not assume that your children will be happy receiving just money from the estate. Sentimental items are often the items that cause the most strife among family members, so you should ask your children if there are any items that they may particularly want in order to prevent disputes and minimize any resentment against your surviving spouse. When items such as photographs, china, jewellery and art are given to a new spouse as opposed to giving them directly to children from the previous relationship, this can lead to disappointment, anger, family tensions, and in some cases, litigation. If there are some items that you want your children to have sooner rather than later (for example, personal items from a deceased parent), you should consider giving them to your children before you die, or specifically leaving them to your children in your will.

If you would like to leave an estate to both your new spouse and your children from a previous relationship, you should speak to your financial planner about how your estate should be structured. You will need to determine two things – first of all, how much of an estate you would either like to leave to your spouse (or are legally required to leave to your spouse) and secondly, how much of an estate you would like to leave to each of your children. You will likely also need to speak to an estates lawyer for confirmation as to how much of your estate your spouse will be entitled to under the laws of your province or territory. Depending upon the situation, you may or may not have sufficient assets to satisfy all the gifts you would like to leave to your family members. When you are reviewing your financial plan, ensure you understand what the after-tax value of your estate is projected to be – your financial planner can tell you what the income tax consequences will be at the time of your death so that you have a better idea as to whether or not there will be sufficient assets to achieve all of your objectives.

### (III) USING LIFE INSURANCE TO SATISFY ALL BENEFICIARIES

For individuals who do not have sufficient assets to leave enough to their spouse to satisfy any potential family property or dependant's relief claims, yet still leave enough for their children, the most common solution is to buy insurance to fund the difference. This will help to ensure that each party will receive the desired amount, and will be free to use their inheritance as they see fit. This is usually the most simple and practical solution, and the option most frequently recommended.

However, caution should be exercised when using this strategy where you have young children. If your children are minors, or even young adults, it may not be a good idea to name them as the direct beneficiaries of an insurance policy. This is because the provincial government may have the authority to manage the funds until they reach the age of majority, resulting in unnecessary expense, and then the children will be entitled to the funds when they are potentially still too young to manage them. If your children are young, consider directing the insurance proceeds to an insurance trust, so that a trusted family member can manage the funds and distribute them over a period of time, when the children are mature enough to use the funds appropriately.

One other limitation to this strategy is the fact that as you get older, you run a higher risk of becoming uninsurable, at least at a reasonable price. Review your insurance needs with your IG Consultant sooner rather than later, since you cannot take for granted the fact that this option will always be available to you.

As can be seen, estate planning for blended families can become quite complex. Speak to your IG Consultant to make sure your estate is structured in a manner that considers the interests not only of your new spouse, but your children as well.

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Christine is Head of Financial Planning at IG Wealth Management, leading our financial planning strategy to ensure that our clients have access to the most advanced expertise. Christine is a member of the Canadian Tax Foundation, has her Certified Financial Planner designation and is a Registered Retirement Consultant and Trust & Estate Practitioner, certified by the Society of Trust & Estate Practitioners (STEP). She is also the recipient of the prestigious STEP Founder's Award. Christine is the author of Wealth Planning Strategies for Canadians, which is published annually by Thomson Carswell and is currently in its 17th edition. Christine has given lectures to numerous professional associations and is a regular media spokesperson for IG Private Wealth Management. Christine has been appointed a King's Counsel for the Province of Manitoba, awarded to lawyers in recognition of exceptional merit in their profession.

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