The Navigator

RBC WEALTH MANAGEMENT SERVICES

Estate Planning for Blended Families ...

Where to Begin with New Beginnings?

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Yours, mine and ours is more and more becoming the norm in our society. And, as anyone who is part of a blended family will tell you, it comes with its own set of rewards and challenges. One area that can be particularly tricky is estate planning, Wills and the division of assets.

The three most important things to keep in mind to make planning for blended families as uncomplicated and equitable as possible is to communicate expectations, protect your own children, and provide for your spouse. Be open with everyone who has a stake in the planning and discuss everyone's needs and desires. It's better to have the difficult conversations upfront and avoid unfounded assumptions from either party, than to deal with conflict down the road as a result of a lack of planning.

Children from a previous relationship need to be considered separately from your spouse. Leaving the decision up to your spouse as to how to divide your assets after your death leaves the door wide open for conflict and hard feelings, regardless of how good the relationship between that person and your children may be. You also need to make sure you plan to provide for your spouse or life partner. Again, leaving that decision up to your children may not go the way you would have wanted after your death.

So, with those three considerations in mind, what else do you need to know before you tie the knot for a second, or perhaps third, time?

The content in this article is for information only. It is essential that you consult your legal advisor to discuss your own circumstances.

New Wills

It is very important to know that in several Canadian jurisdictions, a new marriage renders all previous Wills null and void.[1] The only exception is if the existing Will was made in contemplation of the marriage. If you do not make a new Will after you marry, or a Will in contemplation of marriage before you marry, and then pass away, your estate will be treated as if you died without a Will (intestate) and your estate will be distributed in accordance with the intestacy laws of your province (i.e. the *Succession Law Reform Act* if you reside in Ontario). Therefore, if

1) In Quebec, marriage does not render all previous wills null and void. Under the Wills and Succession Act (Alberta) that came into force on February 1, 2012, a marriage no longer revokes a Will in Alberta. Similarly, in British Columbia, under the proposed Wills Estates and Succession Act , a marriage will no longer automatically revoke a Will once the new legislation comes into force.

you have re-married or plan to re-marry, make preparing a new Will a priority, regardless of how you want to divide up your estate.

Restrictions on Testamentary Freedom

In several provinces, a legally married spouse may apply for the division of matrimonial property upon the death of a spouse. In Ontario, a spouse is entitled to an equalization of net family property pursuant to the terms of the *Family Law Act* (Ontario). If one partner does not adequately provide for the surviving spouse in their estate plan or Will, the surviving spouse can make a claim against the deceased's estate. Similarly, a dependant of the deceased – such as an adult child with special needs – is also entitled to make a claim against the estate if adequate provision for his or her needs has not been made.

Although this discussion deals only with the rights of legally married spouses, persons entering common-law relationships should be aware of their respective rights and entitlements as well. The law surrounding the rights of common-law partners is in a state of flux and common-law partners are being accorded more rights than ever before. Consequently, couples entering common-law relationships should seek legal advice in revising and preparing their estate plans.

Income Tax Implications

While a Will addresses the distribution of assets within an estate, many people also have assets that will pass outside of their estates, either through joint-ownership with another person or by beneficiary designation of a registered plan or life insurance policy.

If you designate a beneficiary of your registered plan or life insurance policy, you should ensure that the beneficiary designations are consistent with the terms of your Will in order to avoid any confusion as to the beneficial ownership of such plans.

In the case of assets for which a beneficiary can be designated, make sure you consider the tax benefits available by naming your spouse as the beneficiary. For example, with a Registered Retirement Savings Plan (RRSP), you can have the full value of the plan roll over to your spouse's RRSP upon your death and defer the taxes that would otherwise be payable on the value of the RRSP until the surviving spouse either withdraws from the RRSP or passes away. If you name your children as the beneficiaries of your RRSP, there may be tax-deferral opportunities if you have financially dependent minor children or grandchildren or dependent children or grandchildren who are mentally or physically disabled. It is also possible to "rollover" the proceeds of your RRSP/RRIF into the Registered Disability Savings Plan (RDSP) of your financially dependent disabled child or grandchild. If you name adult children who do not fall into the above category as your beneficiaries, your children receive the full amount of your RRSP, but the fair market value of your RRSP will be included as income in your year of death and the entire tax liability will fall to your estate.

Proceeds from an insurance policy can also pass outside of your estate and be received free of income tax and estate administration tax provided you designate a beneficiary on your life insurance policy (other than your estate).

Choice of Executor

It's important to give adequate consideration to your choice of executor.[2] Should you choose your spouse as executor, or your spouse and children, or a combination of your children from both prior and current relationships? Consider if, and how well, the individuals will be able or willing to work together on the administration of your

2) Estate Trustee with a Will in Ontario; Liquidator in Quebec.

estate. You may want to think about using a neutral third party to act as executor such as a trust company, lawyer or accountant. While a neutral third party may incur increased costs for the estate, keep in mind that the estate will also incur significant costs if litigation ensues.

Estate Planning Strategies

Having taken into account all of the considerations above, rest assured, there are strategies available to pass wealth on to your children from a previous relationship while still providing for the needs of a surviving spouse as well. These include division during life by gifts, alter ego trusts or joint partner trusts; division after death by life insurance or testamentary trusts. In addition, equalization claims and dependant support claims between spouses, as discussed above, can be released or waived by written agreement.

Division During Life

One option is to make a division of estate assets prior to death in a manner that will satisfy both your desire to leave wealth to your children from a previous relationship as well as your support obligations owed to a surviving life partner. During your lifetime this can be done by making outright gifts or by establishing alter ego or joint partner trusts, for example.

Alter Ego Trusts

As mentioned earlier, the courts can interfere with your estate plan should there be any question as to the adequate and equitable distribution of your estate to your spouse and children. One way to avoid this is to hold assets outside of your estate, through the creation of either an alter ego trust or a joint partner trust. In order to qualify as an alter ego trust under the terms of the *Income Tax Act* (Canada), you must be 65 years of age or older at the time you set up the trust and the terms of the trust must specify that only you are entitled to the income of the trust and that no one else can receive income or capital from the trust before your death. As the assets are held in a trust during your lifetime, at your death, the assets are distributed based on the terms of the trust document, and not your Will. Accordingly, the assets held in an alter ego trust cannot be the subject of any maintenance or support claims made against your estate.

Joint Partner Trusts

A joint partner trust is similar to an alter ego trust. The main difference between the two trusts is that in order to qualify as a joint partner trust, the settlor of the trust and his or her spouse must be entitled to receive all the income of the trust and remain the only persons entitled to receive the income or capital of the trust until the death of the surviving spouse. A joint partner trust ensures that your spouse continues to receive the benefit of the assets during his or her lifetime. Upon the death of the surviving spouse, the assets are distributed to the beneficiaries named in the trust document, which could be the children of your previous marriage.

While there are several advantages to using these kinds of trusts, they are not without their drawbacks. It is important to discuss with your legal advisor how they could apply to your particular situation.

Testamentary Trusts

Testamentary trusts are trusts that come into effect upon death, the terms of which are set out in your Will. Testamentary trusts enjoy special treatment under theIncome Tax Act. Similar to an individual taxpayer testamentary trusts are taxed at graduated rates rather than at the highest marginal rate which is the case for inter vivos or living trusts. Properly structured, testamentary trusts can provide significant tax savings for your surviving beneficiaries,in addition to helping you achieve your estate planning objectives.

Testamentary Spousal Trusts

Another option to provide support to a spouse after death is the creation of a testamentary spousal trust under your Will. Testamentary spousal trusts enjoy several tax benefits. When you die, you are deemed to dispose of all the assets you own and your estate is liable for the income tax owing on the capital gains accrued on those assets. However, if the assets are transferred to a testamentary spousal trust at the time of your death, the deemed disposition on death (and the associated tax liability) can be deferred until the property is either sold or the surviving spouse dies. The trust must provide that only your spouse will receive income (and capital if you desire) from the trust assets during his or her lifetime. Your will can also direct that on your spouse's death, the remaining spousal trust assets will be distributed to your children. Keep in mind that your choice of trustee is critical. To avoid tension, you may want to consider an independent trustee. It is essential to discuss this with your legal advisor.

Life Insurance

Life insurance is often an important estate planning tool for blended families. Because the proceeds of a life insurance policy will be available on your death, life insurance can effectively serve to create an inheritance to leave to your beneficiaries. Designating your children as the beneficiaries of a life insurance policy may satisfy your obligations to them, thereby freeing up your estate to be left to your spouse.

Marriage Contract

Marriage contracts serve multiple uses, particularly in second marriages. They let you protect your assets and enable you and your new spouse to outline what assets each of you will allocate for your respective children. Equally important, a marriage contract takes precedence over any subsequent Will made by either you or your spouse, effectively governing your affairs in the event of your death. They can also be used to settle legal rights in the event the marriage doesn't work out or in the event of your death. Although you can prepare a marriage contract at any time, know that the rules change once you are married.

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