

Estate Planning for Blended Families

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by

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Facts

- wife (Jill) and husband (Mike) have been married seven years, were each once previously married, and are both Canadian citizens
- Jill is 53, divorced, and on good terms with her former husband
- Mike is 42, divorced, and not on good terms with his former wife

- Jill has two children
 - daughter, 23, lives with her father and is not on good terms with Mike, is at university, and has received the engagement and wedding rings from Jill's first marriage
 - daughter, 21, lives with Jill and Mike, works in Jill's company and is interested in taking over when Jill retires, and is to receive the engagement and wedding rings from Jill's current marriage when Jill passes away
- Mike has two children
 - son, 17, lives with his mother and carries on a lifestyle which does not please Mike
 - daughter, 11, lives with Jill and Mike and performs exceptionally well academically and athletically
- Jill and Mike have one son who is 5 years old

- Jill manages the manufacturing business of a company (Opco), and her assets include
 - her engagement and wedding rings, valued at \$15,000
 - an RRSP valued at \$250,000, which designates Mike as sole beneficiary
 - all of the shares of Opco, which are valued at \$5,000,000 and have a cost base of \$100
 - an investment property valued at \$200,000, with an adjusted cost base of \$150,000
 - a \$1,000,000 term life insurance policy on her life, which designates Mike as sole beneficiary
- Jill is subscriber on an RESP for her 5 year old son
- Mike is a junior manager at Opco, and his assets include
 - a vehicle valued at \$30,000
 - an RRSP valued at \$350,000, which designates Jill as sole beneficiary

- a non-registered investment account valued at \$200,000, with an adjusted cost base of \$150,000
- a recreational property valued at \$400,000, with an adjusted cost base of \$150,000
- a \$1,000,000 term life insurance policy on his life, which designates Jill as sole beneficiary
- Jill and Mike jointly own their home, which is valued at \$700,000

- Opco has 100 common shares, all of which are issued to Jill (at \$1 per share), and no other shares
- Opco owns a \$500,000 term life insurance policy on Jill's life, which is intended to fund company expenses until management issues are resolved if Jill passes away
- Jill did not use any of her \$100,000 lifetime capital gains exemption, and has not used any of her enhanced capital gains exemption
- Mike did not use any of his \$100,000 lifetime capital gains exemption, and has not used any of his enhanced capital gains exemption

- Jill has a will which appoints Mike as executor, gives her youngest daughter her engagement and wedding rings, and gives Mike all of her other estate assets – she is considering transferring her investment property into joint ownership with Mike in order to avoid probate fees if she predeceases him
- Mike has a will which appoints Jill as executrix and gives her all of his estate assets – he is considering transferring his vehicle, non-registered investment account, and recreational property into joint ownership with Jill in order to avoid probate fees if he predeceases her

Strategies to avoid a Wills Variation Act challenge (and probate fees)

- gift during lifetime
- joint ownership
- beneficiary designation
- inter-vivos (living) trusts

Other Planning Strategies

- estate freeze
- life insurance
- testamentary trusts (established in a will or in an insurance declaration)

Blended Family Issues and Considerations

- communication and openness between Jill and Mike is extremely important
- should each of Jill and Mike own a portion of their home as tenant-in-common? – if yes, consider establishing a testamentary trust in each will allowing the surviving spouse to continue using the portion of the home owned by the estate of the predeceasing spouse for some period of time
- if Jill predeceases Mike
 - will Mike challenge the gift of rings to Jill's youngest daughter? – if yes, consider having Jill give the rings during her lifetime, using a deed of gift to evidence that the gift was made even if the rings are in Jill's possession when she passes away
 - will any (or all) of Jill's three children challenge the gift of estate residue to Mike? – likely, and so she will have to arrange for her Opco shares and her investment property to pass directly to Mike (through joint ownership) rather than passing into her estate
 - should Jill give a portion of her assets to her three children rather than giving essentially all of them to Mike? – if yes, consider giving the children assets with no associated capital gain, consider whether the gifted assets should be apportioned differently between Jill's daughters from her first marriage and her son from her second marriage, and consider whether those assets should be held in a trust (and, if so, consider whether an inter-vivos trust or a testamentary trust is appropriate, and what trust terms should be included)
 - should assets given to Mike be held in a trust to ensure eventual distribution to Jill's children? – if yes, consider whether an inter-vivos trust or a testamentary trust is appropriate, whether the trust needs to qualify as a spousal trust for income tax purposes, and whether distribution of income and/or capital should be restricted or left to the discretion of the trustee(s)
 - is Mike the appropriate person to act as sole trustee of the various testamentary trusts established by Jill's will? – if not, consider appointing Jill's former husband as one of the trustees of any testamentary trusts holding assets for her daughters, consider appointing a trusted employee as one of the trustees of any testamentary trusts holding Opco shares; and consider appointing a trust company as one of the trustees of any testamentary trusts which may not be wound up within the lifetime of the other trustees or to act as an ultimate decision maker
- if Mike predeceases Jill
 - will any (or all) of his three children challenge the gift of estate residue to Jill? – likely, and so he will have to arrange for his vehicle, non-registered investment account, and recreational property to pass directly to Jill (through joint ownership) rather than passing into his estate
 - should Mike give a portion of his assets to his three children rather than giving all of them to Jill? – if yes, consider giving the children assets with no associated capital gain, consider whether the gifted assets should be apportioned differently between his children from his first marriage and his son from his second marriage, and

consider whether those assets should be held in a trust (and, if so, consider whether an inter-vivos trust or a testamentary trust is appropriate, and what trust terms should be included)

- should assets given to Jill be held in a trust to ensure eventual distribution to Mike's children? – if yes, consider whether an inter-vivos trust or a testamentary trust is appropriate, whether the trust needs to qualify as a spousal trust for income tax purposes, and whether distribution of income and/or capital should be restricted or left to the discretion of the trustee(s)
- is Jill the appropriate person to act as sole trustee of the various testamentary trusts established by Mike's will? – if not, consider appointing a trust company as one of the trustees of any testamentary trusts holding assets for Mike's eldest children, of any testamentary trusts which may not be wound up within the lifetime of the other trustees, or to act as an ultimate decision maker
- if Jill and Mike both pass away
 - consider how to implement the decisions which were made for the event of the passing of one spouse

Other Planning Issues and Considerations

- should the corporate term life insurance be retained or cancelled and, if it is to be retained, should it be replaced with permanent life insurance (or, if possible, converted to permanent life insurance) to facilitate later use of a corporate insured annuity?
- if Jill predeceases Mike
 - should Jill and Mike be joint subscribers on the RESP? – likely
 - will Mike collapse Jill's RRSP plan, giving him the full value of the plan investments and creating an income tax liability for the estate? - if yes, consider a contract between Jill and Mike to ensure use of the spousal rollover
 - does Mike need \$1,000,000 of life insurance proceeds? – if not, consider whether the policy should be cancelled or retained for Jill's children (or, if possible, converted to permanent insurance for her children) and, if it is to be retained, consider whether an insurance declaration should be prepared
 - should the estate plan be flexible enough to have Opco shares available for Jill's youngest daughter if Jill passes away before it is known whether the daughter will assume management of the manufacturing business? – if yes, then consider effecting an estate freeze (or a partial estate freeze), with growth shares held by a fully discretionary family trust and with voting shares to be held by a testamentary trust established in Jill's will
 - is a testamentary trust for Mike advantageous to facilitate income-splitting, or desired by Jill in case of Mike's remarriage after she passes away? – if yes, consider whether the trust needs to qualify as a spousal trust for income tax purposes and whether distribution of income and/or capital should be restricted or left to the discretion of the trustee(s)

- are testamentary trusts for Jill's daughters advantageous to protect their inheritances until they reach an age of financial maturity, and perhaps to facilitate income-splitting even after that age is reached? – if yes, consider whether distribution of income and/or capital should be restricted or left to the discretion of the trustee(s), whether separate trusts (with different trust terms) are needed to hold Jill's Opco shares, and who will receive the trust assets if the beneficiary daughter does not reach the specified distribution age
- what terms are appropriate for a testamentary trust for Jill's son, should the trust be used only to protect his inheritance until he reaches an age of financial maturity or, in addition, to facilitate income-splitting even after that age is reached, and who will receive the trust assets if he does not reach the specified distribution age?
- if Mike predeceases Jill
 - will Jill collapse Mike's RRSP plan, giving her the full value of the plan investments and creating an income tax liability for the estate? - if yes, consider a contract between Jill and Mike to ensure use of the spousal rollover
 - does Jill need \$1,000,000 of life insurance proceeds? – if not, consider whether the policy should be cancelled or retained for Mike's children (or, if possible, converted to permanent insurance for his children) and, if it is to be retained, whether an insurance declaration should be prepared
 - is a testamentary trust for Jill advantageous to facilitate income-splitting, or desired by Mike in case of Jill's remarriage after he passes away? – if yes, consider whether the trust needs to qualify as a spousal trust for income tax purposes and whether distribution of income and/or capital should be restricted or left to the discretion of the trustee(s)
 - what terms are appropriate for testamentary trusts for each of Mike's three children, should separate trusts (with different trust terms) be established to hold any Opco shares which Mike may obtain, should the trusts be used only to protect the children's inheritances until they reach an age of financial maturity or, in addition, to facilitate income-splitting even after that age is reached, and who will receive the trust assets if the beneficiary child does not reach the specified distribution age?
- if Jill and Mike both pass away
 - who would be an appropriate guardian for the five year old son? – consider Jill's youngest daughter
 - do Jill and Mike wish to ensure continued growth of the RESP and/or use of its assets for particular purposes? – if yes, consider including specific directions in their wills
 - is there a need for permanent "joint and last to die" life insurance to fund the tax liability? – if yes, consider whether that insurance should be owned personally or corporately and, if personally, whether an insurance declaration should be prepared (and, if so, consider what trust terms should be included)
 - do they wish to include charitable giving as part of the estate plan? – if yes, consider what steps need to be taken now to ensure that their wishes will be honoured and that the best possible income tax and probate fee relief will be received when they both

pass away

Fifteen Years Later . . .

- communication and openness between Jill and Mike is still extremely important, but now some or all of the five children should be included in the planning discussions
- would an alter-ego and/or a joint-partner trust be useful? – if yes, consider
 - the technical requirements – the trust must be created after 1999, the settlor must be 65 years of age or older, the settlor and the trust must both be resident in Canada, only capital property can be contributed to the trust, the settlor (or the settlor's spouse) must be entitled to receive all trust income while alive, and no other person can be entitled to receive or use the trust capital
 - the advantages – available tax-free contribution of assets, available capital distribution to settlor, *Wills Variation Act* protection, probate avoidance (including probate fees), privacy, and incapacity planning
 - the disadvantages – expense (including transfer costs such as property transfer tax), loss to some degree of control over the trust assets, loss at death of graduated income tax rates, loss to some degree of ability to alter the trust asset distribution scheme, and complexity

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