CLU ADVANCED LEARNING SERIES

CASE STUDY: BLENDED FAMILIES AND PROPERTY DISTRIBUTION

Advocis

Case Study: Blended Families and Property Distribution

Learning Objective

- Identify relevant estate planning objectives and considerations in a blended-family scenario.
- Explain options, alternatives and implications related to potential strategies for the distribution of property while considering client objectives.

Case Study: Blended Families and Property Distribution

Question 1

In the event that Jason and Claire's marriage should not work out, identify the financial issues for each of them and their families. Pay specific attention to issues like: division of assets, the family home, and support payments, with all partners in mind.

When answering this question, apply the matrimonial property, support and other legislative rules as they currently exist in your province of residence.

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Question 1 Solution

A number of issues would have to be considered:

1. The status of ownership and access to the matrimonial home
2. The status of the vacation home
3. Whether the full value of both RRSPs would have to be shared or just the growth since marriage

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Question 1 Solution, continued…

4. Whether the business would be included in "matrimonial property" even though Claire has no involvement with it
   - If yes to above (1 to 4), would the whole value be included or just the growth in value since the marriage?
   - Do either Jason or Claire have any obligations to Jason's children?
   - What support obligations would Jason have to Claire, given their differences in income, but also the short duration of their marriage?
   - What support obligations would Jason have for Claire's daughters, assuming he had not adopted them?
   - The need for a matrimonial contract

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Question 2

Discuss for Jason and Claire four basic methods by which property could pass between them or to their children, outlining the practicality and timing of each method and any tax ramifications.

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Question 2 Solution

There are several ways that property could pass:

- Through their estates, via an intestacy
    - Subject to probate fees
    - Terms of estate distribution public knowledge
    - Children would be entitled to their share (if any) as soon as they reach age of majority
    - Cannot direct which assets to which beneficiary in what amounts – provincial legislation determines who receives an inheritance and the formula for deriving quantum
    - May not be able to "roll" RRSP proceeds tax-free
    - Lawyer's fees

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Question 2 Solution, continued…

- Through their estates, via new wills
    - Subject to probate fees
    - Terms of estate distribution public knowledge
    - Lawyer's fees; executor's fees

- Through joint ownership with rights of survivorship
    - If house or other property is registered in joint title between the couple with right of survivorship, there is no guarantee that children will inherit
    - Properly registered jointly with children could result in partial disposition for tax purposes, and could risk exposure to creditor's of the children

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Question 2 Solution, continued…

- Via beneficiary designations
  - Property transfer only occurs at death of owner
- By inter vivos gifts
  - Disposition for tax purposes unless to spouse
  - Loss of control over gifted property

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Question 3

From the five ideas that Rose suggested to Claire, pick four ideas and explain whether the idea is good or bad. For each of the four you pick, explain your reasoning to support your conclusion as to why it is good or bad.

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Question 3 Solution

A) Ownership of Vacation Home

While joint ownership with right of survivorship would solve both the problems of probate fees and subsequent ownership (and would not be public knowledge), the re-registration could trigger tax reporting of inherent gain on the property, which might or might not be partially sheltered by the principal residence exemption. Additionally, Claire would now need the permission of her daughters to sell, mortgage or otherwise deal with the vacation home. When the property passes to the daughters on Claire's death, they jointly own it with the right of survivorship. This could cause one child's family to lose out on the cottage, which does not align with Claire's objective of passing it through the generations.

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Question 3 Solution, continued...

B) Alternate Executor

While naming an alternate executor, to act in the event that the primary executor is unable or unwilling to assume the role, is a good idea the choice should be given careful consideration. In this case, Claire's cousin is an estate lawyer, obviously experienced in estate administration. However, this remains a bad idea for three reasons:

- The cousin is versed in U.S. and Tennessee estate law, not Canadian law
- If the sole executor is located in the United States, the domicile of the estate could become the United States and the estate could be subject to U.S. estate and tax rules
- The alternate executor is located in Tennessee, hundreds of miles away from Claire, her assets and her family: a serious administrative constraint

Selecting an alternate executor should be given the same scrutiny and consideration given to the choice of the first-named executor.

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Question 3 Solution, continued…

C) RRSP Beneficiary Designations

Directing RRSP funds through a named beneficiary designation does allow the funds to pass outside of the estate and would reduce probate costs. However, when using any probate-planning strategies it is important to consider the full picture and implications, not just the probate savings.

In this case, there is risk putting substantial funds in the hands of the daughters at a very young age (age of majority at the earliest) when they might not be mature enough to manage them effectively. As well, the estate is responsible for the income tax consequences arising from the deemed disposition at death, so a misalignment of asset distribution may occur (unless it is considered when planning the overall estate)

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Question 3 Solution, continued...

D) Counselling and a Marriage Contract

Counselling can be helpful for some couples who are having serious marital issues. In theory, there could be benefits to setting the groundwork for a separation agreement while they are still communicating. Practically, it is often more difficult to ascertain an agreement when tensions are high.

E) Transfer of RRSP to a Life Insurance Company

While it is true that a life insurance RRSP may have some better creditor protection, under the Insurance Act, than a non-insurance contract, the courts have held that a transfer purely for the intent of strengthening creditor protection may leave the asset exposed. Also, the Bankruptcy Act voids the protection for transfers (settlements) that occur less than 12 months prior to bankruptcy. There could also be surrender charges involved with the existing plans.