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.

The Facts

Jason, age 53, and Claire, age 39, married 18 months ago; a second marriage for each of them. Each has two children from a previous marriage. Jason's sons, Alexander (age 22) and Philip (age 19) live with his ex-wife. Claire's daughters, Julie (age 14) and Holly (age 13) live with Jason and Claire and expect to do so until they finish college or university.

Jason wholly owns and operates an incorporated business and draws $150,000 in salary from the company annually. Claire is a self-employed freelance interior designer, a vocation that nets her about $45,000 a year, after expenses, but before taxes.

The home that the couple live in is registered in Jason's name and is valued at $620,000. Jason owned the home prior to the couple's marriage and brought it into the relationship as the family home. Their major assets are summarized below.

Asset Summary

ASSET	OWNERSHIP	WHEN ACQUIRED	FAIR MARKET VALUE	Notes
House	Jason	Prior to marriage	$620,000	
Vacation Home	Claire	Prior to marriage	$210,000	
RRSP	Jason	75% prior to marriage, 25% after	$240,000	Beneficiary – Jason's estate
RRSP	Claire	60% prior to marriage, 40% after	$80,000	Beneficiary – Claire's estate
Incorporated Business	Jason	Prior to marriage; grew $100,000 during marriage	$600,000	Jason is the sole shareholder
Life Insurance	Jason	2+ Years Ago, prior to marriage		Jason is the policy owner and life insured Beneficiary – Jason's estate Term policy with $400,000 death benefit

The beneficiaries for both RRSPs and life insurance on Jason's life were set up shortly after their divorces, before the couple ever met, and have remained unchanged.

Jason and Claire have wills, each naming their children as their residual beneficiaries, in trust until they reach age 25. Jason's will was written shortly after he divorced his first wife and Claire's was executed shortly before she married Jason. She had not had a will up until that point. When it comes to estate planning, the couple are each concerned primarily about protecting the interests of their own children but are not unsympathetic to the needs of a surviving spouse.

Actually, the concerns regarding their respective children, particularly Claire's is a major point of contention in their marriage. Claire's two daughters are still very close to Claire's ex-husband, to the point that the new relationship creates a great deal of friction between Claire and her ex. Fallout from those tensions is a very strained relationship between Jason and the girls, who resent his introduction into the family and have never accepted Jason as their "new father". The family dynamic is, in fact, strained to the point that Jason and Claire are uncertain that their marriage is going to work out.

Regardless of the future of their marriage, you have suggested to Jason and Claire that they need to review their wills, given their dramatically changed circumstances since their divorces. Your discussion regarding wills also has the couple wondering about the most effective methods of transferring property between themselves, or to their children, either during their lifetimes or at death (assuming, of course, that they stay together). They have asked you to put together recommendations regarding ways to transfer their property with an eye to reducing taxes and other expenses, while still meeting their estate and financial planning objectives.

A while ago Claire had a lengthy chat with her neighbour, Rose, about, among other things, financial planning. Rose listens to the financial shows on the radio and has read a couple of books on financial and estate planning and considers herself to be an expert. She offered Claire a series of ideas for her estate:

a) Claire had mentioned that her vacation home had been in the family for three generations and she would like to see it eventually passed down to her daughters, to keep the tradition alive. Rose suggested that the surest and best way to affect this would be to change the ownership to joint with rights of survivorship with the daughters as soon as they reach maturity, at age 21.

b) Rose suggested that, if Claire executes a new will with Jason as her beneficiary and executor, she should also name an alternate executor. Rose suggested Claire's cousin, who is an estate lawyer in Tennessee, in the United States.

c) Since Jason does not need Claire's assets for him and his sons to live on, Rose suggested that Claire change the beneficiary of her RRSPs from her estate to her two daughters, in equal shares, to avoid probate costs.

d) Given that Claire and Jason seem to be having some marital issues, Rose felt that it might be prudent for them to get counselling and to see about putting together a matrimonial contract to deal with financial matters, should a separation be on the horizon.

e) Since Claire operates a sole proprietorship business, Rose suggested that she should transfer her RRSP assets to a plan issued by a life insurance company, and then make the appropriate changes to the beneficiary designations, to provide protection from her creditors.

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.

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
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

Reference:

- *Wealth Planning Strategies for Canadians, 2020 Edition, 5.3 & 5.7*

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.

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

  ***Reference*:**
  - *Wealth Planning Strategies for Canadians, 2020 Edition, 19.4*

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

  References:
  - *Wealth Planning Strategies for Canadians, 2020 Edition, 5.5*

- 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

  References:
  - *Wealth Planning Strategies for Canadians, 2020 Edition, 22.3.1*

- Via beneficiary designations
  - Property transfer only occurs at death of owner

  References:
  - *Wealth Planning Strategies for Canadians, 2020 Edition, 22.3.6*

- By inter vivos gifts
  - Disposition for tax purposes unless to spouse
  - Loss of control over gifted property

  References:
  - *Wealth Planning Strategies for Canadians, 2020 Edition, 22.3.2*

General reference throughout Q2, Estate Planning with Life Insurance, 7th Edition,, page 88

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.

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.

References:
- *Wealth Planning Strategies for Canadians, 2020 Edition, 22.3.1*

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.

References:

- *Wealth Planning Strategies for Canadians, 2020 Edition,, chapter 20*

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)

References:

- *Wealth Planning Strategies for Canadians, 2020 Edition, 22.3.6*
- *Estate Planning with Life Insurance, 7th Edition, 3.1(b)(x) and 3.2(b)*

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.

References:

- *Wealth Planning Strategies for Canadians, 2020 Edition, 5.3.2*

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.

References:

- *Estate Planning with Life Insurance, 7th Edition, chapter 11*

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