Heritage Law*

Heritage Law Blended Family Estate Planning Package

Fees: $7,500.00

Blended families are families where one or both married spouses (or common-law partners) have been in a previous relationship, and have children from that relationship.

A blended family cries out for pro-active estate planning. The failure to engage in such planning increases the likelihood that someone will seek redress from the courts in the event of incapacity, splitting up or the death of one or both of the parties. Generally speaking, a prudent approach is to hope for and expect the best, but to put in place a plan to guard against the worst. Planning is often centered around the "three Ds": disability, divorce (or ceasing cohabitation if common law) and death. The documents that should be considered in each of these categories are as follows:

Disability:

1. Powers of Attorney;
2. Representation Agreements.

Divorce/Splitting Up:

3. Marriage Agreement or Cohabitation Agreement;

Death:

4. Wills (may include spousal trusts).[1]

I. Disability/Incapacity Planning

A **Power of Attorney** is a legal document where you can appoint someone (the attorney) to manage your financial and legal affairs in the event you were unable to do so yourself, for example due to illness, injury or travel. An **Enduring Power of Attorney** remains valid even if the person giving it loses mental capacity. It must be signed before the person loses capacity.

[1] Additional planning options may also be appropriate, including *inter vivos* trusts, beneficiary designations and joint tenancies. After the initial interview, the lawyer will advise if additional strategies are recommended.

A **Representation Agreement** (which is a combined advance health care directive, personal directive and living will) allows you to designate someone you trust to make health and personal care decisions for you should you not be able to make such decisions yourself. If you have any particular health care wishes, you can include them in a Representation Agreement.

II. Divorce/Splitting Up Planning

Marriage and Cohabitation Agreements

Division of property between spouses, including common-law partners, on a relationship breakdown in B.C. is governed by Part 5 of the *Family Law Act*, [SBC 2011] c. 25 ("*FLA*"). Without a marriage or cohabitation agreement, on separation, each spouse has a right to an undivided half interest in the assets that qualify as family property. Each spouse also has an equal responsibility for debts that qualify as family debt. This presumption of equal ownership and division can be rebutted by a spouse who satisfies the Court that an equal division would be significantly unfair, taking into account specific factors listed in s. 95 of the *FLA*.

It is possible for spouses to contract out of the property division regime under Part 5 of the *FLA* by entering into a marriage or cohabitation agreement. Some typical property division arrangements in agreements, which differ from the property division regime under the *FLA*, are as follows:

- Spouses retain their respective property as separate property during and after the relationship ends, except for any property which is specifically registered or recorded in joint names, which is divided equally or in specified proportions;
- All property owned by either party before cohabitation or marriage is kept separate during and after the relationship ends, but assets acquired by either party during the relationship are divided equally, or under Part 5 of the *FLA*;
- All property is kept separate except that a graduated percentage share is acquired over time in property such as the family home and/or RRSPs by the non-owning spouse (eg. 3% per year to a maximum of 50%); or
- All property is kept separate but there is a graduated lump sum compensation to less affluent spouse on a relationship breakdown instead of a share of property.

Agreements are also important to establish the assets and their values that each spouse brings into the relationship, which under the *FLA* is one class of property that is defined as “excluded property”. On separation, excluded property is not subject to division between the spouses, although absent any agreement to the contrary, any increase in the value of excluded property is family property and subject to equal division under the *FLA.*

Agreements can also include provisions which address issues such as obligations for spousal support and responsibility for living expenses.

Effectiveness of Agreements

In 2004, the Supreme Court of Canada decided the case of *Hartshorne* v. *Hartshorne*, [2004] 1 S.C.R. 550 ("*Hartshorne*") in which the Court enforced a marriage agreement in a long-term traditional marriage where the wife's entitlement to property was significantly less than what she would have obtained under the BC *Family Relations Act* (later replaced by the *FLA*). The Court emphasized that an agreement does not need to reflect the 50/50 entitlement provided by the legislation to be substantively fair.

The Supreme Court of Canada decided that, provided that certain requirements are met, the terms of prenuptial agreements will be enforced in all but the most unusual of cases. The Court reasoned that it should avoid substituting its idea of what is fair for what the parties *believed* would be fair at the time they entered into the agreement.

Although the Courts do reserve the right to set aside or overrule any terms in a prenuptial agreement which they find to be significantly unfair under the *FLA*, for example, if an agreement was made with incomplete or misleading financial disclosure, in the post *Hartshorne* environment, Courts are less likely to vary prenuptial agreements.

III. Death

A **Will** sets out who you would like to administer your estate, to receive your assets and to be the guardians of your minor children in the event you died. This allows the maker of the will to make these decisions themselves rather than default to the legislative provisions that apply when a person dies without a will. A Will with a testamentary trust provides that all or a portion of your estate assets may be placed into a trust when you die. A testamentary trust historically received preferential tax treatment, particularly the benefit of graduated income tax rates. However, beginning in 2016, the benefits afforded by use of testamentary trusts were for the most part eliminated by the federal government, except for (1) estates that in the first 36 months comply with the requirements of a "graduated rate estate" as per s. 248(1) of the *Income Tax Act*, and (2) beneficiaries who are eligible for a federal disability tax credit and comply with the requirements of a "qualified disability trust" as defined in s. 122(3) of the *Income Tax Act.*

Estate planning for blended families is difficult due to competing interests: how to leave at least some of your estate to the second spouse, without disinheriting children from a previous relationship. If an estate plan is not structured correctly, there is a risk of litigation and/or an unequal distribution of wealth occurring between branches of a family.

Issues: Assets Left to a New Spouse (both married and common-law spouses)

Many people draft mirror wills which state that upon the first spouse to die, everything goes to the surviving spouse, and upon the death of the second spouse, everything is to be divided equally between both spouses' children. In other cases, the spouses place all assets in joint ownership with a right of survivorship. This planning is risky because the second spouse could change his or her will after the first spouse dies and leave nothing to the step children. Under the *Wills, Estates and Succession Act ("WESA")*, step-children have no recourse or remedy to bring a claim to vary the will of a step-parent.

Issues: Assets Left to Children

Because of a concern that a child from a previous relationship will never see any part of their estate, many parents in blended family situations try to leave money directly to their children. The issues are as follows:

1. A spouse may be entitled to some or all of your estate under common law, the *FLA* and *WESA*. If you leave money to your children during your lifetime or upon your death, your second spouse may take action to undo or vary these transfers.

2. Leaving assets directly to your children may result in significant taxes being triggered. When assets are left to a spouse, any unrealized capital gains can be deferred until the spouse sells the asset or dies. In contrast, when assets are transferred to a child, an unrealized capital gain will usually be triggered on that date (the date of a transfer during your lifetime or upon your death if via a will).

Solution: A Spousal Trust Will

A Spousal Trust Will, also known as "qualifying spousal trust," is where the spouse of the settlor of the trust is entitled to all the income of a trust (and possibly capital) during the spouse's lifetime and, second, no other person can receive or otherwise use any of any income or capital from that trust during the spouse's lifetime.

Control of the Ultimate Destination of Assets

Spousal trusts are effective conduits to ensure capital passes to the next generation of beneficiaries or to otherwise control the ultimate destination of the capital in the trust. This is particularly important for those in second marriages or common law relationships, with children from first marriages or relationships.

The benefits are that the surviving spouse has access to income (and possibly capital) during his or her lifetime, but when the surviving spouse dies the capital will be distributed according to the will of the first spouse, not according to the will of the second spouse to die or the rules of intestacy. This is because the assets never become the property of the surviving spouse – they are the property of the trust. The terms of the

spousal trust can provide that upon the death of the surviving spouse, all the assets are to be distributed among the children of the first spouse (or to trusts in favour of those children).

Spousal trusts can be used in conjunction with other solutions to meet your objectives such as leaving some assets directly to your children, insurance, registered investment beneficiary designations and joint tenancies.

If there appears to be a significant risk that a spouse or children will challenge your will or distribution of your estate after the time of your death, and you are at least 65 years old, you may wish to consider using an alter ego or joint partner trust, which are trusts you create during your lifetime which set out the distribution of trust assets at the time of your death.

Drawbacks of Spousal Trusts

One downside of spousal trusts is that clients must rearrange their affairs so that they each own the assets they wish controlled by the trusts in their name alone. This can involve changing jointly held accounts into separate accounts, changing the designated beneficiary of their RRSPs to "estate" and transferring the house into their names as "tenants in common" from "joint tenants", if these assets are to form part of the spousal trust. This process can take some time and involve some expense.

A second drawback is that probate fees may be payable on some assets on the first to die rather than on the second to die. That said, probate fees are 1.4% of the value of the estate, and the tax reduction offered by a spousal trust can far exceed the probate fees payable.

Solution: Mutual Will Agreement

A Mutual Will Agreement is a written agreement between two spouses to execute Wills and to not change or revoke their Wills without the other spouse's consent. This is a contract at law, and there must be clear evidence of this. Once made and one of the spouses dies, the agreement becomes irrevocable.

An agreement can be a solution to address one or both spouses concerns or fears that if they were to leave all of their assets to their spouse, following death, the surviving spouse may remarry or cohabit in a marriage-like relationship and make a new will that leaves all of their assets to their new partner and/or new partner's children. The surviving spouse could also make a new will that leaves all of their assets to their own children or other beneficiaries, effectively disinheriting the children or any other intended beneficiaries of the deceased spouse. A mutual wills agreement can provide peace of mind that this situation has been avoided, as the courts will give effect to the agreement.

A Mutual Wills Agreement can be revoked while both spouses are alive, with due notice to the other spouse. However, once the first spouse dies, and the second spouse receives

the benefits of the first spouse's Will, the agreement becomes irrevocable. The agreement also becomes irrevocable when one of the living spouses is unable to alter the Will due to incapacity.

Drawbacks of Mutual Wills Agreements

A Mutual Wills Agreement can also create inflexibility in the future. If the surviving spouse were to remarry, he or she may have new obligations, or unanticipated circumstances may arise that would otherwise require changes to the Will. The surviving spouse may need to obtain the consent of the intended beneficiaries in order to make changes to the Will and/or estate plan generally. A carefully drafted Mutual Wills Agreement can help address these potential issues.

Solution: A Joint Spousal or Common-Law Partner Trust

A Joint Partner Trust is a joint spousal or common-law partner trust created by spouses during their lifetimes that allows contributions of capital property on a tax deferred (rollover) basis and specifies the distribution of trust assets after the last of the spouses to die. If there appears to be a significant risk that children will challenge your will or the distribution of your estate, a joint partner trust can be an estate planning tool to reduce exposure to potential wills variation claims.

A joint partner trust is one established by married spouses or common-law partners, one of whom must be at least 65 years of age. Until the last of the spouses to die, no one other than the spouses may receive any of the income or capital of the trust.

If a joint partner trust is an appropriate estate planning solution, additional fees will apply.