

Dependants Relief Planning

*Do you have a client who is divorced and paying spousal support and absolutely, unequivocally, does **not** want his or her ex-spouse to claim a chunk of the client's estate at death?*

Consider the hypothetical posed by the elderly Mr. P. He is happily divorced from his first wife, Betty, but is forced to pay her monthly spousal support. He will have to do that indefinitely – Betty would have trouble getting by without it. At estate planning time, he announces in no uncertain terms that he wants his wealth to be divided between his new wife and a charity, and wants none of it to go to Betty.

Unfortunately, trouble is brewing. *The Dependants Relief Act* (the “DRA”) here in Manitoba defines a “dependant” to include a divorced spouse for whom a deceased person was paying spousal support at the time to their death. Thus, Betty is a dependant. The DRA goes on to state that Betty, as a dependant, is entitled to bring an application against his estate for ongoing support or for a lump sum, which might be large, if she can establish that she is in financial need.

Mr. P rises up in righteous indignation and drops a separation agreement on the table, “Betty signed that, and it states in black and white that she is releasing any claim she might have against my estate under the DRA.” Alas for Mr. P, it is still not over. It is impossible to contract out of the Act. The wording releasing the claim is invalid. Most separation agreements contain that clause. Many lawyers don't know that it is invalid. The law on point was not clearly settled until *Davids vs. Balbon* was decided by the Manitoba Court of Appeal in 2001. Mr. P is shocked. He paid her nearly \$500,000 as a Family Property Act settlement when the

divorce went through sixteen years earlier -- “she got her pound of flesh” he states. Will she succeed in securing a second pound of flesh if he dies?

Betty still has to prove “need” if the court is to give her a chunk of his estate. She squandered much of the \$500,000 settlement. Mr. P’s fortunes rose significantly after he divorced her (“she was an albatross around my neck” he adds), and he is delighted to now have a net worth of over four million dollars. The spousal support he pays her rose over the years as well, from an initial monthly figure of \$1,000 to the \$3,500 he currently pays. It looks like he has real trouble. Betty might get a huge payout if she attacks his estate. “What can I do?” he asks.

Broadly speaking, he has two options. First, he can try to terminate the spousal support obligation so it is not in place at his death. Since *Moge vs. Moge* was decided by the Supreme Court of Canada that has been hard to do for litigants in his shoes. Since he may have real trouble forcing it on her, he will need her consent. He can approach her and offer to buy out the spousal support stream in return for a lump sum. If her life expectancy is taken into account, a present value can be calculated to capitalize the income stream. She might be given a lump sum of, say, \$700,000 to invest. She would release her claim to spousal support in return for that lump sum, something she *can* do in a contract. That would have the effect of terminating her status as a dependant and the resulting ability to claim against his estate. The lump sum might appeal to Betty. She would gain independence from the monthly payment he makes, and control over a lump of capital.

Assume she tells him to take a hike, happy with the prospect of suing his estate and annoying the “trophy wife” he married after the divorce. What can be done then?

Here is his second option. He can empty his estate. There are a variety of ways to do that. One would be to place his property in joint names with rights of survivorship with his new wife. When he dies, the property would go to the new wife and do so outside of the estate. The same result occurs with registered investments and life insurance designating his wife or the charity Mr. P favours as a specific beneficiary. To the extent that this strategy works, it is because section 2 the DRA states that Betty can claim “against the estate” of Mr. S. If the estate is empty she is attacking an empty husk. Does it work? Yes, but Betty will not be without opportunities to counterattack. Taking a lesson from an Ontario case called *Stone vs. Stone*, she might be expected to allege a fraudulent conveyance under *The Fraudulent Conveyances Act*. If successful, the assets would be placed by the court back into Mr. P’s estate, available to satisfy any claim she might bring and win under the DRA. Careful planning would limit her chances of success.

This second option is at risk of disappearing. The Manitoba Law Reform Commission recommended in 2004 that the government add anti-avoidance provisions to the DRA. Those provisions would extend the reach of the DRA to assets in joint tenancy and the proceeds of insurance and RRSP designations, bringing them back into the pot to be claimed by Betty. The government may never act on the recommendation. Even if it does, the wording in the current recommendation provides an exception for *inter vivos* trusts if Mr. P is willing to settle a trust on terms that give up any claim he might have to the capital. Included in that exception, and seemingly protected from Betty, will be charitable remainder trusts and the type of alter ego trusts normally structured in Alberta to allow a Manitoba resident to secure access to Alberta rates.

Then Mr. P might consider putting half of his assets in a charitable remainder trust (he was planning to give half of his wealth to a

charity in any event). It would provide tax relief to him now, and he would still have access to the income. The charitable remainder trust would be resistant to any DRA claim, even if the current recommendation becomes law. It would be hard to attack as a fraudulent conveyance, as the trust serves a variety of easily seen planning objectives, not just defeating Betty's claim. This might make sense for the half of his wealth he wants to see go to charity.

As to the other half, he could set up an alter ego trust. He would be the trustee and the sole income beneficiary. After his death, the capital would go outside of his estate to his new wife. Does he want access to Alberta tax rates? If he structures the trust to give up any possible chance that the capital might revert to him or come under his control, the trust will not be subject to attribution under subsection 75(2) of the Income Tax Act, and he can then enjoy the income and have it taxed in the hands of the trust under subsections 104(13.1) and (13.2). If the trustees reside in Alberta, the income will be taxed at the top Alberta rates, instead of the top Manitoba rates. Charitable remainder trusts and alter ego trusts are planning vehicles normally reserved for the wealthy. If our hypothetical Mr. P had less wealth, it might not be worthwhile to consider them.

Mr. P might consider a third option. If he is willing to send the capital offshore into a different country, he could consider setting up an asset protection trust in a country with favourable laws. Some countries will not honour or enforce a Canadian judgment in favour of Betty against a trust established there, or have limitation

periods that are functionally impossible for Betty to meet. The setup costs are typically high, and the tax issues complex, but it is said to be a popular strategy for Dependents relief planning for the wealthy. The wealthier Mr. P becomes, the more he might like to consider this last option. Some advisors would suggest that he

already has enough wealth to consider this option, others would suggest that his net worth would have to be far higher.

This article was written in 2004 and is an introduction to the topic, is general in nature, and is not a substitute for legal advice. Individuals planning to structure or restructure their affairs should consult a lawyer for assistance specific to their needs and circumstances.