

## ESTATE PLANNING FOR BLENDED FAMILIES

### A. Introduction

Second marriages and common-law relationships can create conflict between the survivors of a deceased spouse. This is especially true where the deceased has children of a first marriage or common-law relationship and legal obligations arise as a result of a second marriage or common-law relationship. The commonly held desire to transfer wealth to children from the first marriage or relationship may be at odds with the provincially legislated statutory regime in Manitoba, and other Provinces in Canada, which create and govern rights between spouses and common-law partners to each other's estates.

These legislated rights and obligations have only recently been extended to same and opposite sex common-law partners, which has further complicated estate planning. Prior to June 30, 2004 one was assured that absent a second solemnized marriage the transfer of wealth to children from a prior marriage was a relatively unobstructed estate planning objective, subject only to the claims of dependant(s) under the Dependents Relief Act of Manitoba. When the Common Law Partners Property and Related Amendments Act was proclaimed in force in Manitoba on June 30, 2004, that estate planning objective was potentially unwittingly stymied by the mere effluxion of time while living with a common-law partner.

This paper is intended to briefly outline some of the issues that confront the estate planner in second marriage and relationship situations, and discuss some strategies available to address those issues.

## **B. Statutory Law**

A triumvirate of Manitoba Statutes creates significant rights and obligations as between spouses and common-law partners related to the marital home and rights to share in each other's estates. Those Acts are: the Dependants Relief Act; the Homesteads Act; and the Marital Property Act.

### Dependants Relief Act

The Dependants Relief Act provides authority for a court to order for reasonable provision to be made from the estate of a deceased for the ongoing maintenance and support of a surviving dependent that is found to be in financial need.

An application under The Dependants Relief Act for an order for reasonable support requires the applicant to firstly show that he or she is a dependant and secondly to show that he or she is in financial need.

Both married persons and common-law partners are included within the definition of a “dependant” under the Dependants Relief Act.

A common-law partner of a deceased is defined under the Dependants Relief Act as a person who, not being married to the deceased, cohabited with him or her in a conjugal relationship for a period of at least 3 years, or at least 1 year where there is a child of the union.

Recently in *Davids v. Balbon*, (2001), Mr. Justice Schulman of the Manitoba Court of Queen’s Bench, considered an interim application by a surviving common-law partner for an order of support under the Dependants Relief Act.

A cohabitation agreement existed, which purported to waive and release the applicant’s entitlement to a claim under the predecessor legislation to the Dependants Relief Act. Mr. Justice Schulman concluded that dependants, including spouses, are not able to contract out of the provisions of the Dependants Relief Act.

The agreement signed by the couple in *Davids v. Balbon* was ineffective in terminating their rights under the Dependants Relief Act.

The decision of Mr. Justice Schulman was appealed. In 2002 the Manitoba Court of Appeal confirmed that the cohabitation agreement that the applicant had signed, by which she purported to release her rights under the predecessor legislation to the Dependants Relief Act, was a valid enforceable contract, however, any benefit she received under the agreement would be taken into consideration by the court in determining her financial need and therefore her entitlement to support under the Dependants Relief Act.

For estate planning purposes the significance of the Dependants Relief Act and the Davids v. Balbon decision is the possibility that ultimate distribution of the estate of a deceased will be subject to the prior statutory obligation to provide for a dependant, including a spouse or common-law partner.

Although spouses or common-law partners can enter into an agreement to abrogate the rights afforded by the Dependants Relief Act, if at the time of death the survivor can demonstrate financial need, then the agreement will be subject to an order of the court providing for support for the surviving spouse.

Effectively, spouses and common-law partners cannot make an agreement between them to waive future rights under the Dependants Relief Act.

The obligations created by the Dependants Relief Act will supersede the testamentary objectives of a testator where the goals expressed in a will limit intended distribution to a dependant, including a spouse or common-law partner.

In addition, testators must keep up with changing legislation. The legislation in effect at the time the parties entered the cohabitation agreement in *Dauids v. Balbon* specifically allowed common-law partners to release their rights to a claim for support from the estate of the other. The successor legislation, the Dependants Relief Act, which was in effect at the time of the application, does not allow contracting out of its provisions. The guiding legislation for considering the issue was the legislation in effect at the date of the application, not that in effect at the date of the agreement. The change to the legislation effectively thwarted the intention of the parties as expressed in their cohabitation agreement.

### Homestead(s) Act

The Homesteads Act of Manitoba creates rights between married persons and common-law partners to the marital home.

The rights created by the Homesteads Act include a life estate interest, allowing a spouse or common-law partner to live in the marital home until his or her death, as well as the right, during his or her life, to prevent the marital home from being transferred or encumbered.

Unlike the Dependents Relief Act parties are at liberty to release their rights under the Homesteads Act.

A release must:

- be in writing;
- be signed before a person authorized to take affidavits in Manitoba;
- be acknowledged by the releaser to have been made separate and apart from the releaser's spouse/common-law partner;
- confirm that the releaser is aware of his or her rights under the Homesteads Act;
- acknowledge that the effect of the release is to give up his or her rights under the Homesteads Act; and
- acknowledge that he or she is releasing such rights freely and voluntarily, and without compulsion on the part of his or her spouse/common-law partner.

In addition the release should be executed with the benefit of independent legal advice and have attached to it a certificate of independent legal advice.

For estate planning purposes homestead rights have a deferring, as opposed to a preventative, effect.

A spouse or common-law partner can, by will, ultimately transfer a marital home to children from a first marriage, however that transfer will be subject to the surviving spouse's/partner's continued homestead rights and interests during his or her life.

With the advent of the new common-law partners' legislation it has become possible that a deceased will have a spouse and a common-law partner exist simultaneously. A challenge is to determine which of the two persons has Homestead rights to property. Under the Homestead's Act, the first person to acquire Homestead rights in the property maintains those rights until such rights are waived, released or terminated.

### Family Property Act

A surviving spouse or common-law partner may apply under the Family Property Act for an accounting and equalization of marital property.

Where a person by will purports to leave a spouse or common-law partner an amount less than that person's entitlement under an accounting and equalization the spouse/common-law partner is entitled to the amount determined by the accounting.

The accounting process is not simple. In addition to the assets that are subject to an accounting between living spouses/common-law partners under Part II of the Family Property Act, certain assets are included in the inventory of the deceased spouse/common-law partner, to the extent the deceased spouse/common-law partner did not receive adequate consideration in respect of the asset, for the purposes of the accounting, including:

- gifts made by the deceased spouse/common-law partner to another person by will;
- assets jointly held by the spouse/common-law partner and another person to the extent of the deceased person's interest in the property so held;

- benefits under retirement savings plans, retirement income fund or annuity, or a pension, retirement, welfare or profit-sharing fund, trust, scheme, contract or arrangement for the benefit of employees or former employees payable to someone other than the spouse/common-law partner;
- the cash surrender value of a life insurance policy payable to another person;
- proceeds of life insurance payable to the estate; and
- any other payment payable to the estate as a result of the death of the deceased spouse/common-law partner.

All of the above referenced assets, when included in the inventory of the deceased spouse/common-law partner, become subject to the accounting and equalization as between the estate and the surviving spouse/common-law partner.

Certain assets are excluded from the inventory of the surviving spouse/common-law partner for the purposes of the accounting, including:

- assets jointly held by the surviving spouse/common-law partner and deceased spouse/common-law partner where the surviving person has a right of survivorship;

- life insurance payable on the death of the deceased spouse/common-law partner;
- benefits under retirement savings plans, retirement income fund or annuity, or a pension, retirement, welfare or profit-sharing fund, trust, scheme, contract or arrangement for the benefit of employees or former employees payable to the surviving spouse/common-law partner on the death of the deceased spouse/common-law partner.

All of the above assets are excluded from the inventory of the surviving spouse/common-law partner, and are not therefore included in the accounting and equalization as between the estate and the surviving spouse/common-law partner.

Amounts payable to a spouse/common-law partner by intestacy of the deceased spouse/common-law partner or by gift under a will are deductible from the amount the surviving spouse/common-law partner is entitled to receive under an accounting under the Marital Property Act.

A court has no discretion to alter an amount payable under an accounting under Part IV of the Marital Property Act, which part applies to surviving spouses/partners.

### **C. Estate Planning Strategies**

What do these statutorily created rights and obligations as between spouses and common-law partners mean to estate planning?

First and foremost testators need to be aware that any testamentary intention to inadequately provide for a surviving spouse/common-law partner, may be challenged by the surviving spouse/common-law partner.

There are, however, strategies available to a testator to pass wealth on to children from a first relationship without offending the rights of a surviving spouse or common-law partner.

1. Division During Life - One option is to make a division of estate assets prior to death in a manner which will satisfy both the personal desire to leave wealth to children of a former relationship and the obligations of support and maintenance owed to a surviving spouse or common-law partner. This can be done in assorted ways:

a) Gifts During Life - A person can make an outright gift of assets during his or her life to children. If the person's current spouse/common-law partner is aware of the gift he or she has a limited period of time to have the gift included in a Family Property Act accounting, being 2 years from the date of the transfer. If the spouse/common-law partner is not aware of the gift, then the 2 year limitation period begins running from the date the spouse/common-law partner became aware of the gift.

By making the spouse/common-law partner aware of a gift to children of a previous marriage the spouse/common-law partner is afforded only a limited window of opportunity to challenge the gift. Unless the marriage or relationship is, at the time of the gift, on shaky grounds, then a gift under these circumstances will likely succeed.

That time period can be further abridged, or eliminated, by written agreement. Persons are able to opt out of the accounting processes under the Family Property Act.

A spouse/common-law partner can be asked to acknowledge and approve the gift, release his or her rights to a post-mortem accounting under the Family Property Act or release all of his or her rights under the Family Property Act.

At the time of such an agreement the spouse or common-law partner should be fully apprised of the extent and nature of the financial affairs of the other spouse/common-law partner, consult a lawyer for purposes of obtaining independent legal advice and execute an acknowledgement and release in the presence of such independent counsel.

The point to remember is that gifts, made during one's life, that are excessive or for inadequate consideration are subject to being made part of an accounting under the Family Property Act if they are not otherwise excluded by agreement or effluxion of time.

If the gift is made "mortis causa", being one made in contemplation or anticipation of death, then the gift is specifically included in the accounting and the above considerations do not apply.

#### b) Alter Ego and Joint Survivor Trusts

An Alter Ego Trust can be created if:

- the settlor (maker of the trust) is 65 years of age or older

- the trust is created after 1999, under which the settlor declares a trust over trust property to be held by trustee(s) under certain trusts
- the settlor is entitled to be the sole recipient of all of the income from the trust during his/her life
- no other person is entitled to receive any income from the trust or make use of any of the capital of the trust during the settlor's life
- the trust does not elect out of the rule that deems the trust to dispose of all of its property on the death of the settlor

The property transferred from the settlor to the trust is transferred on a tax-deferred basis.

The trust will be deemed to have disposed of all of the trust property upon the death of the settlor and the capital from the trust can be distributed to or be held for the benefit of persons specified in the trust document.

A joint spousal or joint partner trust is generally similar to the alter ego trust except that the income is shared or used by the settlor and his or her spouse/common-law partner until the death of the survivor and the trust is not deemed to have disposed of its property until the death of the survivor of the settlor and his or her spouse/common-law partner.

Use of an alter ego or joint spousal/partner trust may successfully avoid a claim by a surviving spouse or common-law partner under the Dependents Relief Act, since a dependant's claim under that Act is against the estate, and the trust is a relationship that is separate from the estate.

This may change in the future if recommendations from the Law Reform Commission's 2003 report on Wills and Succession Legislation are adopted, which include recommendations to prevent this form of avoidance.

In addition, the provision under the Family Property Act which authorises a court to vary the terms of a trust to satisfy payment of a share payable to a surviving spouse/common-law partner under an accounting and equalization is limited to a trust established by will and does not apply to an alter ego or joint spousal or joint partner trust.

Some ancillary considerations related to alter ego or joint partner trusts include: the possible loss of control of the trust assets; the immediate legal costs of creating the trusts; the ongoing accounting costs related to maintaining the trust; and the cost of trustee fees and tax considerations.

2. Division After Life – Another option is to make provision for division of estate assets after death. This can be done in assorted ways.

a) Life Insurance

Life insurance affords an effective means of providing for children of a former marriage. By naming children as designated beneficiaries under a life insurance policy the proceeds of insurance are not included in an accounting under the Family Property Act, although, the cash surrender value of the life insurance policy immediately before the death of the insured is included.

Making the spouse/common-law partner the designated beneficiary under the life insurance policy does not resolve the concern because the Family Property Act excludes from an accounting any life insurance proceeds payable to the surviving spouse/common-law partner. Care must be taken to ensure the designated beneficiaries are the children.

b) Testamentary Trusts

A testamentary trust can be created which will provide for the ongoing maintenance and care of a spouse/partner during his or her life, authorising the trustee(s) to distribute income and/or capital to the surviving spouse/partner during his or her life and distribute any amount remaining in the trust after the death of the surviving spouse to others, including children from a previous marriage, in accordance with the terms of the trust.

The trust allows the spouse/partner to continue to maintain his or her style of life through the receipt of income and/or capital during his or her life and allows for the generational distribution of the testator's wealth to his or her children after the death of the surviving spouse/partner.

This strategy is subject to review by a court. Subsection 41(4) of the Family Property Act provides that a testamentary trust can be varied by a court to satisfy an amount payable under a post-mortem accounting and equalisation. As stated above spouses can opt out of some or all of the provisions of the Family Property Act. A simple one page agreement, called a quit claim deed, can be annexed to the will, by which the testator's spouse/common-law partner waives any rights to challenge the testamentary trust. This should be accompanied by full financial disclosure and independent legal advice.

Similarly, the surviving spouse/common-law partner, if qualifying as being in financial need under the Dependents Relief Act can challenge a testamentary trust.

An additional advantage to the testamentary trust includes the potential tax advantages to the spouse through preferential tax treatment on income generated by the trust assets during her life.

Additionally, there may be further tax advantages to ultimate capital beneficiaries through the continued holding of their distributive shares of the estate in trust.

Income earned within the trust can be taxed within the trust, and is treated as a separate taxable entity by Canada Customs and Revenue Agency, and is therefore entitled to the advantages of the graduated tax system employed under the Income Tax Act of Canada. This creates an opportunity for income splitting.

#### c) Promises

A less secure method of resolving the issues associated with blended families is to rely on a promise of the surviving spouse/common-law partner to distribute the couple's collective estate, upon such survivor's death, in a manner that will comply with the intention of the first spouse/common-law partner to die, to ultimately benefit his or her children.

The survivor inherits all of the couple's combined wealth, but promises to give some or all of it to the other's children. The promise would require the surviving spouse/common-law partner to maintain a will which gives some or all to the wealth to the deceased children.

The promise can be oral (non-binding) or written, although it is recommended that it be in writing.

This strategy ensures the spouse/common-law partner has no claim, nor any need for a claim, under either the Dependents Relief Act or the Marital Property Act.

Difficulties with this strategy include: the possibility that the surviving spouse/common-law partner will spend all of the capital of the estate during his or her life; the possibility that the surviving spouse/common-law partner will renege on the promise, which if only oral, will not be actionable by the children of the deceased spouse/common-law partner, and even if in writing will require what could be a lengthy and costly legal process; and the possibility that the surviving spouse/partner remarries or enters a subsequent common-law relationship, thereby encumbering the estate with the statutory rights and obligations of the new spouse/common-law partner.

#### **D. Information in this Paper not Substitute for Legal Advice**

This paper is intended as an introduction to this topic. It is not a substitute for specific legal advice tailored to a client's particular needs.

Any person wishing advice on how to order their affairs, or those of a client, should contact a member of our Wealth and Succession Practice Group. This paper is also based on the laws of Manitoba, and while laws are similar from Province to Province, the content of this paper may not be accurate in other provinces.

## **E. Conclusion**

Providing for the distribution of wealth to children while remaining on-side of statutory obligations to spouses/common-law partners in blended family situations can be complex and challenging.

This paper only touches on some of the issues that must be given consideration. Each person's particular situation will guide the strategy that is best suited to achieving the goals of supporting surviving spouses/partners and transferring wealth to future generations.

There is no substitute for sound legal, financial and tax advice in creating and implementing the most advantageous and desirable estate plan.

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