

Hull on Estate and Succession Planning Podcast #53

Beneficiary Designation Considerations for Spousal Trusts

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Suzana Popovic-Montag: Hi, and welcome to Hull on Estate and Succession Planning. You are listening to Episode #53 of our podcast on Tuesday, March 27th, 2007.

Welcome to Hull on Estate and Succession Planning, a series of podcasts hosted by Ian Hull and Suzana Popovic-Montag, that will provide information and insights into estate planning in Canada, from the offices of Hull Estate Mediation in Toronto, Ontario, Canada. Here are Ian and Suzana.

Ian Hull: Hi Suzana.

Suzana Popovic-Montag: Hi there Ian.

Ian Hull: We spent some time in our last podcast talking about estate planning in the context of the married couple and the importance to do a Will. Also, we looked at adding in the children component and talked about how we might want to allow for the trickle out of the payments of money to the children during their lifetime. The other area that we talked about was the common disaster clause, and the importance that we consider this issue before we go and give our instructions to the lawyer who created the Will.

Suzana Popovic-Montag: And then at the end of our podcast, we talked about the fact that we'd turn now to a discussion of spousal trusts.

Ian Hull: So the spousal trust, and we touched on a little bit, well at least, we don't pretend to be tax experts. But in our last podcast, we touched a little bit on some tax issues that can arise, and US citizenships, and the need for an election to be made and the provisions for that in the Will itself. A spousal trust is established in a lot of situations, relatively complex situations, but in situations that are almost always motivated by tax reasons. And the tax reasons, to put it simply, is that when someone dies and owns assets in Canada and in the US, there's a tax payable on death, on the growth or the increase in that asset during lifetime, if it hasn't been paid already. So one way to avoid that tax is to create a trust in your Will, where the asset flows into the trust and there is no tax paid, no deemed disposition paid on the death of the first spouse. But the taxes paid on the death of the second spouse, so you're allowing for a significant, in some cases, deferral of the payment of the tax.

Suzana Popovic-Montag: And a typical spousal trust will provide the spouse with the right to the income that's going to be generated by those assets put into the spousal trust, together with, often we'll see, a right to encroach on the capital of that trust. But that encroachment can only be by the spouse itself and not for the benefit of any other beneficiary under the Will.

Ian Hull: And in addition, while a lot of spousal trusts are created and motivated for tax reasons, an additional important reason for a spousal trust is issues of control. And issues where you want your surviving spouse, for example, not to feel the pressure that he or she must give a whole bunch of the money away during their lifetime. For example, the surviving spouse, he would be maybe feeling a lot of pressure from the children in some situations to distribute the assets before he even dies, when if you create a spousal trust, you can hide behind that trust and say look, I don't have access to the assets, I only have access to the income, kids, stop bugging me for money before I die.

Suzana Popovic-Montag: And that's particularly important in second and further marriage situations or in blended families where there's children from other relationships.

Ian Hull: Yeah and I think that's, that second marriage situation is so crucial because, in some situations, spouses don't think through the scenario that does happen. And that is, of course, if one dies and then the other surviving spouse lives for many years, that surviving spouse may well end up in another relationship. Well, the surviving spouse will be holding all of the assets of the combined family at that point, will then enter into a new relationship with a new spouse and that may dilute what ultimately goes down to the children. And I'm not sure that that issue is always thought through, except the fact that it can occur in many situations. And it should be thought through by a couple when they come in to see the lawyer at the first instance.

Suzana Popovic-Montag: That's a good point Ian, and I know I've mentioned that typically we see the right to encroach on capital as a provision of these kinds of trusts. But sometimes, in fact, a testator or a trustee might decide that they don't want to provide that kind of provision, that they only want the spouse to have the right to income, so as to preserve the capital of the estate as much as possible for the children or whoever the gift over beneficiaries ultimately are. But do you see any possible dangers with that kind of planning?

Ian Hull: Well, the difficulty always is, is to predict how much you're going to need in terms of income during your lifetime. And what happens, certainly in Ontario is, is that if you create one of these trusts that is essentially protecting for the second family, and that is, just giving income to the surviving spouse and no right to encroach, that surviving spouse may, on your death, simply ignore that Will, elect under the provisions of the *Family Law Act*, and may end up taking a very different combative approach to the estate plan, essentially trying to break down the estate plan because he's going to say look, I don't have enough income on, if I have to live on income from a trust that's established, it's only got \$800,000 in it. I can't survive on that. So he may take a more aggressive approach and try to break down the whole estate plan. So there's a balancing act of giving enough, but not giving too much, so that you can allow for all of these scenarios. But it's a difficult balance.

Suzana Popovic-Montag: And you've always got the benefit of hindsight.

(Laughter)

Ian Hull: That's right.

Suzana Popovic-Montag: I guess one other thing you want to keep in mind when you're doing an estate plan where you think, you're thinking about a spousal trust, is the fact that you ultimately do have to have enough assets to put into the trust. And the reason I mention that is because so often we see partners or spouses do a lot of joint planning, so that they're putting their assets in joint or holding them jointly with right of survivorship. So that at the end of the day, on the death of the first spouse, everything passes to the second spouse and there's nothing left necessarily to go into the estate of the pre-deceasing spouse.

Ian Hull: And another administrative concern always is that running a trust is expensive. You need professionals, you need annual tax filings, and you've got to be careful that you don't create a trust that is economically nonsensical, and that you're ending up spending more on the professional fees than it would justify holding the trust and creating the trust itself.

Suzana Popovic-Montag: And then, of course, you have the consideration of who you should name as your trustee as well, and that's not always the easiest decision to make.

Ian Hull: Alright, so let's talk a little bit about a potential, we talked about the second family potential tensions. Another tension that can get created is when someone leaves an asset to a beneficiary other than the spouse. And obviously, we're not talking about a situation where you disinherit necessarily the spouse, but where a significant asset is left to another beneficiary. So in those situations, I think what we have to do is, generally speaking, we can't forget two important things with married couples. And that is, and even with common-law spouses, but for different reasons. And that is that your married couple scenario, they are going to have significant claims. And when I say they, the surviving spouse is going to have significant claims. So if you end up being overly generous with a family friend or a nephew or something in your Will, you may again trigger the surviving spouse to take steps that actively challenge the whole estate plan. Because what you've done is, is that you've simply given away too much to an individual, non-married individual, and you've upset the balance. Again, it's really comes down to a balancing act as to how you want to, if you want to treat other people outside of your spouse in your Will, even your children or we call, in this case, a third party beneficiary, you want to make sure that you don't do so, so generously that it could upset the whole balance of the estate, and then essentially what you've done is you've walked yourself into estate litigation.

Suzana Popovic-Montag: And I guess one way to sort of avoid that through the Will is to actually deal with maybe beneficiary designations. Where, if you do want to benefit third people or third parties, you'd do it by perhaps naming them a beneficiary of, for instance, your life insurance or your RRSP or your RRIF.

Ian Hull: And that's a great estate planning technique for a bunch of reasons, but one that is a good, easy sort of source of funds for an individual to create. What might be a good idea, and when we say this, one of the scenarios that we run into most often is simply where a surviving spouse has been maybe too generous with a charity. And that's most common, when you get a situation where the spouse really, really wants to benefit a charity, the gift is so significant that it upsets the balance, it doesn't leave enough for the surviving spouse to enjoy a healthy, financial happy life. And what it did was just create tension and litigation because that surviving spouse ends up essentially attacking the estate plan.

Suzana Popovic-Montag: And I guess that sort of brings to mind the fact that even when you make direct beneficiary designations of certain instruments that you may own, that wouldn't necessarily mean that those couldn't be attacked as well. Just like a Will might be attacked, so could these designations, whether it be for lack of capacity or allegations of undue influence or whatever. And that's something that we wouldn't necessarily always think about.

Ian Hull: Yeah, and for example, in Ontario, the surviving spouse can directly attack an insurance designation, essentially claw that gift back into the estate to provide for him or herself. So in our next podcast, I think what we can do is maybe create a little bit of a checklist of some of these other considerations that we want to look at. We've already talked about the beneficiary designation considerations, but talk a little bit about some of the other steps that we want to consider. Certainly, protecting for separation and divorce and maybe dovetail in some of this with insurance planning and those kinds of items that you want to just sort of put on your list, check them off if they apply to your situation. So we'll wrap this up today and talk about that at our next podcast.

Suzana Popovic-Montag: Thanks very much Ian, I look forward to it.

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