

## **Spousal Trusts – How to Protect Both Your Spouse and Your Children**

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In past years my views on general estate planning principles have been set out in these sections. Today I wish to delve into what is, in my opinion, one of the most sensitive subjects and underutilized tools for estate planners – spousal trusts.

A trust is created when there is a transfer of property from an individual to one or more persons, known as trustees, for the benefit of named individuals, known as beneficiaries.

There are two types of trusts. Testamentary trusts are those set out in wills, which take effect on the death of the testator. Inter vivos trusts are those created during life and set out in a trust deed. This article will focus on one type of testamentary trust – the spousal trust.

### **The Problem:**

Many couples arrange their affairs according to what I call “Estate Planning 101” principles. They own all of their assets jointly and designate each other as beneficiaries of their RRSPs and life insurance policies. They want to leave all of their assets to each other outright and on the second spouse to pass away their joint estate is then divided equally among their children.

This plan complies with the requirements and may well achieve the much-publicized goals of “Estate Planning 101” – to minimize probate fees, which are about 1.5% of the value of the estate and are only a critical factor in larger estates, and to simplify the administration of the estate.

Yet this typical estate plan can result in catastrophic consequences far more important to the clients than possible probate fee savings or ease of estate administration. Control is lost because wills are revocable and it is only if both spouses die at the same time that they can be 100% certain that their joint assets will devolve to their beneficiaries set out in their wills.

One of the most troublesome issues encountered by estate planners is the possibility of remarriage by the surviving spouse. After the first spouse passes away the survivor may remarry which would void the original will and could result in the new spouse obtaining a share of the original couple’s joint assets by way of a new will, gifting or by operation of law. Spouses in second marriage

situations often leave the house to each other as joint tenants and designate their new spouse as the beneficiary of their RRSPs for the tax-free rollover. The children from the first marriage may receive some assets but they very rarely receive that which was contemplated in the original wills. I have even seen situations where the husband has children from a first marriage but he leaves his entire estate to his second wife and his children end up receiving no inheritance when the second wife dies. This sometimes results in estate litigation and always leads to fractured family relationships.

Problems can arise even where the surviving spouse does not remarry. Several of my elderly clients have amended their wills to disinherit, or severely reduce a bequest to, one of their children. Sometimes the client had good reasons for doing so however, in other cases declining capacity leading to perceived "slights" played a part. It is also possible for the spouse to be taken advantage of or spend the money foolishly.

### **The Solution:**

I recommend that all clients consider setting up spousal trusts for each other in their wills. For those in second marriages with children from the first marriages I consider spousal trusts mandatory. Others that should give spousal trusts serious consideration for their control and asset protection benefits include those that own a family business or have otherwise built up considerable wealth during life. Spousal trusts may also be of interest to first marriage couples if they are concerned about possible second marriages after the first spouse passes away, with a view to ensuring that at least some of their assets ultimately go to their children.

To establish a spousal trust each spouse leaves his or her assets to a trust for their spouse for life. Trustees are appointed to manage the trust and can pay the income to the spouse each year and encroach on capital for the benefit of the spouse as required from time to time. The trust sets out who is to receive the balance of the capital of the trust fund on the death of the surviving spouse, typically the children or trusts established for the children if they are minors, spendthrifts or disabled. Choice of trustees is critical to ensure the proper functioning of the trust. The surviving spouse can be one of the trustees, but not the only one or the control benefit is lost. It is recommended that at least one impartial trustee be appointed and I am often asked to fill the role.

By establishing spousal trusts each spouse achieves the most important estate planning goals – taking care of each other during life and being 100% certain that his or her assets devolve to their children equally and not to a second spouse.

Another major benefit is that spousal trusts, like all testamentary trusts, enjoy graduated tax rates. Accordingly, when a surviving spouse is the beneficiary of a considerable spousal trust he or she receives substantially more after-tax income

annually than would have been the case had the funds been inherited outright and the income taxed in their hands as personal income. While most clients utilize spousal trusts for both the control and the tax benefits, spousal trusts can be set up for the tax savings alone.

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. Most couples must change their jointly held accounts into separate accounts; change the designated beneficiary of their RRSPs and life insurance to “estate” and transfer the house into their names as “tenants in common” and not as “joint tenants” if these assets are to form part of a 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.

In my opinion spousal trusts are far too under-utilized today. There are several reasons for this. Many estate planners are not familiar with the benefits, structure and implementation strategies involved and are also uncomfortable raising this rather sensitive topic with their clients. There is also a lack of knowledge on the part of the public. Couples should insist that their lawyer fully explain the pros and cons of using spousal trusts before providing final instructions for the preparation of their wills.

Trusts are very complex legal tools and I recommend that you retain the services of a lawyer expert in their use so that your testamentary wishes are carried out and your family is fully protected.