

Sue and George:

A Case Study on Trusts for a Surviving Spouse



Would you like to maximize the after-tax income of your surviving spouse if you die first? Do you want to ensure that your wealth stays in the family in the event your spouse remarries? Both of these objectives can be achieved through the use of a spousal trust.

A surviving spouse will have complete freedom to dispose of his or her inheritance if no trust is imposed. This can cause concern in the event the surviving spouse remarries, or where there are children from an earlier marriage.

Let's look at an example. Sue and George were married for 30 years when Sue died suddenly of a stroke. Under Sue's Will, or as a result of joint ownership, George became the sole owner of the family home and all unregistered investment accounts. He was also the beneficiary of Sue's registered plan and life insurance.

George was devastated by Sue's death, however, within two years he falls in love and marries Nina, a widow with three children of her own. George takes early retirement and he and Nina intend to travel extensively to pursue their mutual interest in golf. George has not bothered to make a new Will despite being advised that his marriage revoked his old Will. George's net worth is now over \$1,000,000, plus he has a secure source of retirement income from his own group pension plan.

Sue and George had two children who are now concerned that George may be too generous with Nina and her family at their expense. They fear he may dissipate his wealth, or fail to ensure that when he dies, they receive their fair share. In addition, before her death, Sue was providing financial support for her aging mother, whose health has now deteriorated. George never got along with his mother-in-law, and recently the children have been required to supplement the increasing cost of her care, as George is not willing to increase his level of financial contribution. All of this is causing considerable ill feeling among George, his children and Nina.

In this example, Sue died first, but the problems could just as easily arise if George had died first and Sue remarried.

George and Sue could have provided protection for other family members and preserved family harmony by placing all or a portion of each other's inheritance in a trust. A trust could have also provided a level of protection from a family law claim by Nina. And if George dies without a Will, a trust could have ensured that Sue's assets do not pass to Nina under the provincial formula for division of an estate where there is no Will.

A number of tax and legal details must be addressed in the course of setting up trusts for a surviving spouse. It might be necessary to sever joint ownership of property or change the designated beneficiary of life insurance to fund the trusts. In this case, for tax reasons, Sue's mother might have been provided for in a separate trust with George as an alternate or residual beneficiary. The family law rights of the surviving spouse also need to be considered, and these vary by province.

A spousal trust for a surviving spouse also provides potential tax savings for the income on the inheritance. In our example, tax savings of \$10,000 per annum or more could have been realized if the income from Sue's life insurance and non-registered investments was channelled to George through a qualifying spousal trust created in her Will. The tax saving is possible because a trust created in a Will is entitled to its own graduated marginal tax rates, and even income paid to a beneficiary can be taxed in the trust at those lower rates.

The income tax benefits of a trust in a Will are often in themselves sufficient to create spousal trusts as part of an estate plan. The terms can be more liberal where there is no concern about preserving capital or protecting the surviving spouse from themselves or the claims of others.

Professional advice is essential to having an effective estate plan. Your BMO Nesbitt Burns Investment Advisor can help introduce you to an estate planning professional for assistance with your personal estate plan.

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