Estate planning for blended families

Wealth Management

Today, many families face new challenges in estate planning due to the changing family dynamics from divorce, remarriage, domestic partnerships, etc. Everyone needs a written estate plan, but married couples with blended families especially need to get things down on paper. If there is no written estate plan, state laws will determine where everything goes when the first spouse dies, and the results might not be ideal.

Why it matters

In some jurisdictions, for example, two-thirds of a decedent's estate will go to children from a prior marriage or relationship if there is no written estate plan. At the same time, a surviving spouse generally has the right to claim a share of a decedent's estate, typically one-third or one-half, if the decedent's written estate plan doesn't provide adequate support. Depending on state law to settle an estate may work in some cases, but in many cases it does not meet the needs of a blended family.

Prenuptial agreements generally spell things out, but not all couples have this agreement in place. And unless there is a written estate plan, a prenuptial agreement may have no impact on what happens at death.

Unique circumstances

For blended families, one of the first things to decide is who to provide for and to what degree. Does it make sense for everything to remain with the survivor at the first death or should all or a portion go to children from previous relationships? And what about children from the current marriage or the surviving spouse's children? Are there child support obligations that have to be met? The answers to these questions will determine how the estate should be structured.

Specific goals

Just as spouses in a blended family may have children they describe as "mine, yours and ours," they are likely to have assets that could also be described in the same way. They could have assets each brought to the marriage from prior employment earnings or that were inherited from deceased parents or even from a deceased spouse. How those assets were acquired can have a major effect on how they are viewed by each spouse.

Many individuals say they want to see "family money"—inheritances, in particular—stay in their personal bloodline. They may be happy for their new spouse to have an income from those assets and to have access to principal for medical expenses or other necessities, but they want to preserve as much of the principal as possible for their own descendants.

A common solution is to hold those assets in trust, with the surviving spouse as an income beneficiary and the decedent's children designated to receive the principal at the second death. This type of trust structure can seem like an easy solution, but it might also put the children in the uncomfortable position of having a living step-parent between them and their future inheritance.

What you can do

As a result, estate planning specialists frequently suggest leaving an immediate inheritance to the children, with the balance held in trust. If the estate isn't large enough to make an upfront gift to the children possible, their inheritance could be funded with a life insurance policy. The insurance proceeds provide immediate liquidity for the children, who also know they will eventually benefit from the trust assets, or that their descendants will, in the event their step-parent outlives them.

Special considerations

How should your heirs inherit the money? What do you need to consider before establishing your estate plan?

- **Spouse —** Should your surviving spouse have full control of the assets and therefore have the ability to change the ultimate heirs?
- **Children —** Do you want your child's inheritance to be subject to divorce claims or creditor claims? Will the inheritance create an estate tax issue for them (particularly in states that impose an estate tax)? Are your children financially responsible?
  - If minors, who will be guardian(s)/conservator(s)?

Who should control the wealth after your death? Who should serve as executor of your estate, and who should be the trustee of any trusts? In even the closest of families, making the surviving spouse or one set of children responsible for everything could set the stage for a great deal of discord.

- **Spouse —** Should your spouse have full discretion to withdraw income and principal with no additional oversight? The survivor could drain the trust and thereby negate the purpose of it.
- **Children —** Should your children determine what is reasonable for distributions to your surviving spouse? Since they would be the remainder beneficiaries, this is a potential conflict of interest.
- **Independent third party —** Provides objective guidance and oversight while keeping competing financial interests from spoiling family relations. Some options are:
  - Individual, non-family member
  - Professional trustee, such as a CPA or attorney
  - Corporate trust company

Many families decide to engage an independent third party, a corporate trustee, to serve alone or as a co-fiduciary with family members. The family representatives understand family dynamics and priorities, while the independent trustee brings objectivity, years of practical administrative experience—and the ability to serve as a tie-breaker.

Beneficiary designations

Naming a spouse (or anyone else) as the beneficiary of insurance policies, retirement accounts or transfer/pay on death accounts puts that person in total control of the assets when the initial account owner dies. The survivor is then free to leave those assets to their own children or perhaps to a new spouse if the survivor remarries.

Every family is different, and even basic estate planning can seem unnecessarily complicated. Estate planning for blended families can be even more challenging. For assistance in determining strategies that will optimize your estate plan, talk to your RBC Wealth Management financial advisor. They, along with their team of wealth strategists, can help you make well-informed decisions that are effective for you and your heirs.

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