Use of Trusts and Beneficiary Designations for the Average Wealth Client

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Estate Planning for the Average Wealth Client

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INTRODUCTION

Clients arrive at an estate practitioner's doorstep with endless variability in concerns, assets, personal circumstances, family structures, and estate planning goals. Fortunately, estate practitioners have a variety of planning tools at their disposal to assist them in creating estate plans that fit each client. Recognizing the usefulness and special application of each tool can help practitioners both anticipate and effectively respond to the needs of clients. This paper will cover a number of tools available to practitioners, including beneficiary designations, spousal trusts, basic testamentary trusts, discretionary family trusts, alter ego and joint spousal trusts, and *inter vivos* discretionary family trusts.

BENEFICIARY DESIGNATIONS

Section 71 of the *Wills and Succession Act* (the '*WSA*') permits an owner of a plan or policy to designate a beneficiary to receive its benefits in the event of the owner's death.[1] Beneficiary designations allow a testator to avoid probate by passing the benefit of a plan outside the estate of the deceased and directly to the beneficiary. Probate avoidance techniques are ubiquitous in estate planning owing to their ability to simplify the estate and avoid creditor claims. Beneficiary designations remain an easy way to accomplish both.

While beneficiary designations have many advantages in estate planning, with improper care they may result in unintended legal effects, adverse income tax consequences, and frustration of testamentary intentions. I tell my clients that while beneficiary-designated assets fall outside one's estate, they are part of one's overall estate plan and must be considered. To avoid the above pitfalls, this section will go over how certain beneficiary designations can be used to best coordinate the distribution of the deceased's assets.

The most common assets which include beneficiary designations are life insurance, Registered Retirement Savings Plans ("RRSPs"), Registered Retirement Income Funds ("RRIFs"), Tax Free Savings Accounts ("TFSAs") and pensions.

[1] *Wills and Succession Act*, SA 2010, c W-12.2, s 71.

Life Insurance Designations

Avoiding Creditor Claims

Life insurance is an excellent estate planning tool, particularly for insolvent estates. Section 731(1) of the Insurance Act provides that life insurance proceeds are not subject to the claims of creditors.[2] Further, section 660(1) of the *Insurance Act* allows an owner of a life insurance policy to designate a beneficiary of the insurance proceeds through contract or declaration, which includes the insured's will.[3] Through a beneficiary designation, the insurance proceeds pass directly to the beneficiary outside of the estate of the insured and remain outside the grasp of creditors. If estate practitioners are working with clients with large amounts of debt, life insurance is one method of ensuring that a testator will have some funds to pass on to his or her beneficiaries.

Similarly, life insurance proceeds are protected from family maintenance and support claims under s. 88 of the *WSA*.[4] If a family member (which for the purposes of the provision includes a spouse, adult-interdependent partner, disabled child, child under eighteen, and a child under the age of twenty-two who is enrolled full-time in school) is not listed as the designated beneficiary of a life insurance policy, he or she is unable to access the insurance proceeds in order to satisfy a successful claim against an estate. The *WSA* creates rights for family members only in regard to the estate of the deceased, and insurance proceeds flow outside of the estate. Note that the insurance proceeds will be used in the calculation of a claim against the estate, but cannot be accessed by the claimant as part of an award. The Court of Queen's Bench of Alberta has recognized life insurance as a valid estate planning tool for managing claims for maintenance and support.[5]

Common Problems with Life Insurance Designations

While life insurance designations are a great estate planning tool, the perceived simplicity and benefits that make them attractive can lead to an array of problems if they are not used properly. Testators frequently manage their beneficiary designations without consulting their estate planner, and unintended consequences can result. Consider the scenario where a life insurance beneficiary predeceases the insured. If there is no alternate beneficiary named on the policy – and there

[2] *Insurance Act*, RSA 2000, C I-3, s. 731(1).

[3] *Ibid,* ss. 660(1) and 662.

[4] *Supra* note 1, s. 88.

[5] *M (KM) v M (MG)*, 2002 ABQB 100 at para 66.

frequently is not – upon the testator's death the insurance proceeds will flow into the estate, and its creditor-proof status will be lost.[6]

Similarly, if a testator names multiple beneficiaries on the insurance form, and one of those beneficiaries predeceases the testator, the insurance proceeds will be payable only to the surviving listed beneficiaries.[7] This is a marked contrast to rules on intestacy and often is counter to the common wishes expressed by testators for beneficiaries of their will: testators frequently want the deceased beneficiary's share to pass equally amongst that deceased beneficiary's children. This is not the default position of beneficiary designations, and testators do not know this.

An additional problem arises if a testator names his or her minor children as beneficiaries. If the document does not also name a trustee for the funds, then upon the testator's death, the insurance proceeds will be paid to and held by the Public Trustee until the minor children reach the age of eighteen. To most parents, both government involvement and this age of distribution would be a cause for alarm. Parents typically want insurance proceeds to be held on trust for their children until the children are more mature, or they want the proceeds safeguarded until they can be first used for their children's post-secondary education. Further, most testators would prefer to have their choice of trustee manage the money, rather than the office of the Public Trustee.

An additional drawback to the Public Trustee is that the trustee will invest in a government packed programme which will guarantee 2.5% return, no more and no less. A different investment strategy, such as one with greater risk but higher yield, may be preferable for a testator with a large estate and a very young beneficiary. Such an estate would benefit from an investment strategy outside the definition of the prudent investor rule in ss. 2 through 8 of the *Trustee Act* and s. 36(1) of the *Public Trustee Act*.[8] The prudent investor rule operates on the notion of minimizing risk through diversity. It follows a similar framework as the 'modern portfolio theory': investments in a portfolio should be structured such that expected return is maximized for the given level of risk, and such return and risk should not be calculated individually, but in context of the portfolio's overall risk and return.[9] This is safe, but restricted.

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[6] *Supra* note 2, s. 664(1)

[7] *Ibid*.

[8] *Trustee Act*, RSA c T-8, ss. 2-8; *Public Trustee Act*, SA, C P-44.1.

[9] Harry Markowitz, "Portfolio Selection," The Journal of Finance, Vol. 7, No. 1. (Mar, 1952), pp. 77-91.