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Family Law Considerations in Estate Planning

by

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I. INTRODUCTION

The areas of family law and estate law are surprisingly intertwined. One of the primary concerns a family lawyer has is to ensure that his or her client is advised of issues surrounding wills, taxation, and estate planning. With forethought and the assistance of experienced professionals knowledgeable in estate planning, we can save our clients a great deal of money.

This paper summarizes some of the areas of family law that have particular relevance to estate planning. It is in no way comprehensive, but merely provides an overview of some of the topics that should be considered when planning for the future.

II. THE FAMILY RELATIONS ACT

The *Family Relations Act* provides for relief similar to that provided under the *Divorce Act* for custody, guardianship, access, spousal support and child support. In addition, the *Act* provides for certain remedies such as restraining orders and enforcement of foreign maintenance orders as well as a wide range of remedies for determination and division of assets on the breakdown of marriage.

The remedies relating to child custody, guardianship and access as well as child and spousal support are available to unmarried spouses as long as they come within the terms prescribed by the *Act*. In other words, they must have lived with another person (of the same or opposite sex) in a marriage-like relationship for a period of at least two years and they must apply for relief under the *Act* within one year of ceasing to live together as such. On the other hand, remedies relating to determination and division of assets are available only between parties who are or have been married, unless unmarried spouses (including same-sex spouses) enter into a property agreement under Section 120.1 of the *Act.* If they do so, the remedies under Part 5 of the *Act* apply. It is important to note, however that there are a number of upcoming changes we can expect to see in the legislation affecting domestic couples. These proposed changes will be discussed later in this paper.

The death of a spouse brings up many issues in the family law context. For instance, a family law agreement may contain provisions which bind the deceased spouse's estate after his or her death. It is common for such an agreement to contain a clause obligating the estate to continue to pay child or spousal support payments after death of the payor spouse.

Notwithstanding what is contained in a marriage agreement, however, the last will made by the testator is the one that is effective, even if that will breaches a term contained in a separation agreement (*Re Kerr*, [1948] 3 D.L.R. 668 (Ont. S.C.)). A spouse who contracted with the

testator on marital separation may have a claim against the estate of the testator for breach of the separation agreement or for breach of a contract to make a will. He or she may also have a claim under the *Wills Variation Act* or against the beneficiaries of the estate pursuant to the laws of equity (*Pratt v. Johnson*, [1959] S.C.R. 102; *University of Manitoba v. Sanderson Estate* (1998), 47 B.C.L.R. (3d) 25 (C.A.)).

From the perspective of a lawyer negotiating a separation agreement or making submissions in court for an order respecting child or spousal maintenance, it is important to negotiate a clause or term of order such that maintenance will be binding on the payor spouse's estate. To further secure both spousal support and child support, counsel often negotiate clauses or terms of an order such that the payor spouse will be compelled to maintain life insurance from the date of execution of the agreement with sufficient value to cover the cost of ongoing maintenance after his or her death. It is not uncommon for the payee of support to be named as beneficiary of the payor spouse's life insurance policy in order to facilitate payment of maintenance going to the surviving spouse or child.

Again, failure to maintain such life insurance as agreed to under a separation agreement or as ordered by a court, is actionable as against the testator's estate (*Ladner v. Ladner* (1997), 30 B.C.L.R. (3d) 144 (C.A.)). Where there is no agreement or order binding the estate of the deceased payor spouse, the obligation to pay maintenance ends when the payor dies (*Despot v. Despot Estate* (1992) 95 D.L.R. (4th) 62 (B.C.S.C.); *British Columbia (Public Trustee) v. Price* (1990), 43 B.C.L.R. (2d) 368 (C.A.)).

III. INHERITANCE – "FAMILY ASSET"?

The term "family asset" is defined in Section 58 of the *Family Relations Act* as property owned by one or both spouses and ordinarily used by a spouse or a minor child of either spouse for a family purpose. The definition may, and often does, include the following:

- a share in a corporation or trust;
- property over which a spouse has a power of appointment exercisable in favour of himself or herself;
- property disposed of by a spouse, but over which that spouse has a power to revoke the disposition or a power to use or dispose of the property;
- money held in a savings account if the account is ordinarily used for a family purpose;
- a right of a spouse under an annuity or a pension, home ownership or retirement savings plan; and
- a right, share or an interest of a spouse in a venture to which money or money's worth was, directly or indirectly, contributed by or on behalf of the other spouse.

According to Section 59 of the *Family Relations Act*, the definition of "family asset" also includes property used primarily for a business towards which a direct or indirect contribution was made by the non-owning spouse to the operation of the business.

The phrase "ordinarily used for a family purpose" has, over time, been given a broader and more liberal meaning by the courts. The courts have gone out of their way to find that assets which may not have formerly been considered to be family assets, are just that. In the past, spouses could protect certain assets by leaving them outside of the realm of the family. For instance, investments held outside of the country were often protected as long as the asset or the income from the asset was not used for a family purpose. As time goes by, the courts look behind the intentions of the parties to find, for instance, that an asset was pegged for providing financial security for the future of the family or for the parties' retirement. The asset would then be subject to the provisions of the *Family Relations Act* pertaining to division of family assets on marriage breakdown, notwithstanding that it has, technically speaking, not been used for a family purpose as of the date of separation.

There is a presumption that all family assets will be divided on an equal basis between spouses, unless it would be unfair having regard to the criteria set out in Section 65(1) of the *Family Relations Act*. The criteria set out in Section 65(1) are as follows:

- the duration of marriage;
- the duration of the period during which the spouses have lived separate and apart;
- the date on which the property was acquired or disposed of;
- the extent to which the property was acquired by one spouse as an inheritance or gift;
- the needs of each spouse to become or remain economically independent and self sufficient; and
- any other circumstances relating to acquisition, preservation, maintenance, improvement or use of property or the capacity or liabilities of a spouse.

Inheritances and gifts from parents or other third parties are treated just as any other asset in that they must be assessed as to whether or not there has been ordinary use for a family purpose, or a contribution made to the asset from the non-inheriting spouse (*Barnard v. Barnard* (1987), 7 R.F.L. (3d) 163 (S.C.)). If the inheritance or gift is determined to be a family asset, as with other assets, the presumption of equal sharing of the asset will apply. The asset will then be subject to reapportionment based on the factors set out above.

Generally speaking, the earlier in the marriage that an inheritance is given to one spouse, the more likely that inheritance is to be viewed as a family asset. Similarly, the longer the duration of the marriage, irrespective of when the inheritance was received by one spouse, the more likely the inheritance is to be viewed as a family asset.

In *Hefti v. Hefti* (1998), 110 B.C.A.C. 44, it was held that in the absence of clear evidence of an opposite intention, there is an inference that monies inherited by a spouse will be used to the mutual benefit of both spouses, whether for present or future purposes, such as for future financial security. Again, the court no longer looks only to the past for what has been done with the asset to date, but it looks at the intentions of the parties with respect to future use of the asset in determining the question of whether it is a family asset or not. As with all family assets, the parties can put forth arguments for reapportionment of the asset, which, in some cases, can be up to 100% reapportionment in favour of one spouse, depending on the facts at hand.

The facts in the *Hefti* case were as follows: The parties were married for 28 years. On the question of division of assets, the trial judge awarded the wife a 60% share in the family home, which was valued at $458,000 at trial. The husband's large inheritance which had been invested mostly in off-shore accounts, was excluded from the division of assets on the basis that it was not used for a family purpose and therefore not considered to be a family asset. The wife appealed the trial decision and was successful. The Court of Appeal awarded the wife a one third share in the husband's inherited monies and maintained that she have a 60% share in the matrimonial home, but with a finding that the matrimonial home had an actual value of $620,000 at the date of trial.

The court found that it was not only the past use of the asset but the future intentions of the parties that was relevant to the determination of whether the asset was a family asset. The court ignored the husband's argument that his mother intended the inherited monies to be solely for her son's benefit, finding that it was irrelevant. Since Section 47 of the *Family Relations Act* provides that the onus to prove that a certain asset is not a family asset lies with the party disputing the claim, it was up to the husband in this case to prove that the monies were <u>not</u> intended for the parties' future retirement once the wife asserted that they were.

Of particular significance in this case was the fact that the court, without the assistance of counsel, made reference to Section 65(2) of the *Family Relations Act* and stated that even if the inherited monies held in off-shore accounts were not found to be family assets, they would still be available for reapportionment to redress any unfairness found to exist, having regard to the factors set out in Section 65(1) - an innovative and surprising finding.

IV. <u>TRUST AND CORPORATE INTERESTS – "FAMILY ASSETS"?</u>

A. SECTION 58(3)(a)

According to the *Family Relations Act*, the definition of *family asset* includes:

- S. 58(3)(a) – if a corporation or trust owns property that would be a family asset if owned by a spouse,

  (i) a share in the corporation, or

(ii) an interest in the trust

owned by the spouse.

For instance, if a person owns shares in a corporation, those shares will be a family asset if the company owns an asset that would have been a family asset if owned by the person owning the shares. Similarly, if a person is the beneficiary of a trust, that beneficial interest in the trust would be a family asset if the trust owns an asset that would have been a family asset if owned by the person owning the interest in the trust.

Similarly, it is arguable that the capital of a trust is a family asset where it can be shown that the trust capital would be a family asset if owned by one of the spouses and that that spouse has a power of appointment over the trust capital, exercisable in favour of himself or herself (i.e. is a capital beneficiary of the trust). This argument is made stronger in a situation in which there have been distributions made from the trust which have been used for family purposes.

It has been ordered that where a trust makes a distribution to a spouse, that spouse holds a percentage of that distribution in trust for the other spouse (*Grove v. Grove*, [1996] B.C.J. No. 2436 (B.C.S.C.). If the trust in question is a fully discretionary trust, however, notwithstanding its characterization as a family asset, the value of the interest in the trust will be zero since any entitlement under the trust is in the sole discretion of the trustee.

B. SECTION 58(3)(e) and SECTION 59

The definition of *family asset* also includes:

- S. 58(3)(e) – a right, share or an interest of a spouse in a venture to which money or money's worth was, directly or indirectly, contributed by or on behalf of the other spouse; and

- S. 59 – (paraphrased) property used primarily for business purposes by one spouse but contributed to directly or indirectly by the other spouse.

With reference to these two sections, some examples of <u>direct</u> contributions include the following:

- paid or unpaid work in a business (*Flewin v. Flewin*, [1996] Civ. L.D. 169 (B.C.S.C.), affirmed, [1997] Civ. L.D. 738 (B.C.C.A.));

- contribution of family assets or use of such assets to acquire or maintain a business asset (*Karaa (McBurney) v. Karaa* (1985), 48 R.F.L. (2d) 416 (B.C.S.C.)); and

- assuming risks such as mortgaging or pledging a family asset or guaranteeing a loan (*Campbell v. Campbell* (1991), 26 R.F.L. (3d) 354 (B.C.C.A.).

Examples of indirect contributions include the following:

- savings through effective management of the parties' household;
- child rearing responsibilities carried out by the non-owning spouse; and
- fulfilling the other spouse's expectations in occupying a social role in the marriage. For instance, acting as a "confidante and sounding board" for the other spouse (*Piercy v. Piercy* (1991), 31 R.F.L. (3d) 187 (B.C.S.C.))

When a marriage breaks down or when one spouse dies, the other spouse may be left with the task of attempting to gain access to a trust that has been set up by the other spouse. One way of doing so is to attack the validity of the trust if there are grounds for doing so. The downside of having a trust set aside in order to gain access to its assets, however, is that there would likely be significant tax consequences as a result of doing so.

C. SECTION 66(3)

Pursuant to Section 66 (3) of the *Family Relations Act*, where the court is satisfied that a spouse has made or intends to make a gift of property to a third person for the purpose of defeating a claim to an interest in the property that the other spouse may have under the *Act*, it may make an order to restrain the making of the gift or transfer, or to vest all or a portion of the property in, or in trust for, the other spouse. It is arguable that this section could be used to set aside a trust set up during a marriage where it is shown that the intention of the spouse setting up the trust was to divest himself or herself of family assets so that she would not have to divide those assets with his or her spouse. However, given that the main reason for setting up such trusts is to avoid certain tax consequences, it may, in some circumstances, be difficult to prove that the trust was set up for any other purpose.

In *Rahman v. Chase Bank*, the husband tried to put his assets beyond the reach of his wife in an off-shore trust. However, after setting up the trust, the husband acted as though there was no trust in existence, treating the assets owned by the trust as though he owned them personally. The court found that the trust was a sham because the husband had never transferred control of the assets to the trustee. He was found to be the beneficial owner of the assets (*Rahman v. Chase Bank (C.I.) Trust Co. Limited* (1991), J.L.R. 103).

Where a party intends certain assets to be owned by a trust, they, along with the trustee and beneficiaries of the trust, must treat those assets accordingly. For instance:

- they should not be included in a list of the person's assets;
- insurance for the assets should be purchased in the name of the trust; and
- the assets should be registered in the name of the trust or in the name of the trustee "in trust" for the trust.

Where a parent wishes to set up a trust for an adult child, it is advisable that the trust be created and assets transferred to the trust prior to the cohabitation or marriage of that child. This will protect the trust from a claim pursuant to Section 66(3) of the *Act* (the anti-avoidance provision).

D. SECTION 68

Section 68 of the *Family Relations Act* contains a provision that permits a court to inquire into an "ante nuptial or post nuptial settlement affecting either spouse". Normally, such settlements are agreements entered into by the parties to the marriage on separation. However, an argument can be made that a trust set up by a third party (such as a parent) for the benefit of one spouse may be subject to review under this section. In other words, the court may be asked to inquire into the trust and make an order that will provide for the application of all or part of the trust property for the benefit of either or both spouses or a child of a spouse or of the marriage.

This argument has not been tested in our courts to date. The argument, to be successful, would include a finding by the court that "ante nuptial or post nuptial settlement" includes settlements other than those entered into between the two spouses. Tracing this section of the *Act* to its English roots, an argument can be made that Section 68(2) gives a court the authority to inquire into a settlement that affects either spouse, with no requirement that the trust be settled by a spouse. This argument is purely speculative at this time and, as stated, it remains to be tested by the British Columbia courts.

V. COHABITATION AGREEMENTS

A cohabitation agreement is an agreement made between two parties who do not intend to marry. These agreements are typically concerned with keeping property owned by the parties separate. They are normally drafted with a view to the cohabitation ending and they set out the division of assets that will occur in that event.

A cohabitation agreement, much like a marriage agreement, referred to below, can be overridden by a court. If such an agreement is unfair, it may well be set aside, depending on the circumstances. Generally speaking, these agreements are more likely to be upheld if they are entered into without duress or undue influence and if both parties have sought independent legal advice. Agreements may also be set aside on the basis of unconscionability, fraud or non-disclosure.

As stated earlier, the property division regime set out in Part 5 of the *Family Relations Act* does not apply to unmarried couples. However, once these couples have entered into a cohabitation agreement under Section 120.1 of the *Act* (the property agreements provision), the remedies to address an unfair agreement will apply equally to both unmarried and married couples. The same principles also apply whether the cohabitation agreement is between heterosexual or same-sex couples.

In the near future, we will likely see legislative changes which will result in all couples being treated similarly under the province's marital property laws, regardless of their sexuality and regardless of whether or not they marry. For instance, there are changes in the works which would result in Part 5 of the *Family Relations Act* applying in a similar way to married spouses, "domestic partners" and couples living together in a marriage-like relationship for more than ten years. "Domestic partners" would be those people who have agreed to be recognized as being in a marriage-like relationship. They would do so by signing a "domestic partner declaration" under the proposed "Domestic Partnership Act". Section 120.1 also may be revised so that it will not apply to an agreement that expressly or impliedly waives the application of Part 5 of the *Act*.

VI. MARRIAGE AGREEMENTS – USEFUL OR USELESS?

A marriage agreement may be defined as an agreement that is entered into between two parties before or during a marriage but before separation. Agreements entered before marriage are often referred to as pre nuptial agreements. A similar type of agreement can be entered into once the parties have been married for some time.

The *Family Relations Act* uses the term "marriage agreement" in reference to any family law agreement, including separation agreements. Marriage agreements are very similar to cohabitation agreements. They are more likely to be upheld if they are seen as "fair" in the circumstances and are entered into with both parties having had the opportunity to discuss their rights with a lawyer before signing. Similarly, they are more likely to be upheld if they are entered into without duress, undue influence or unconscionability (which would typically come from the other spouse) and with full financial disclosure from both parties. As set out above, marriage agreements are subject to review under Section 68 of the *Family Relations Act.* The primary basis for the review is whether or not the agreement is fair.

Examples of situations in which a marriage or cohabitation agreement may be required include situations where:

- one or both parties have very valuable assets; or
- one or both spouses want a particular asset to remain intact on separation.

Separation agreements are frequently entered into when a marriage or marriage-like relationship comes to an end. Such agreements are often incorporated into the terms of a consent order in the parties' Divorce or *Family Relations Act* proceeding.

An interesting case to note is that of *Wagner v. Wagner Estate*. In that case, the parties had entered into a separation agreement on the breakdown of their marriage. Nine years later when the testator/husband died, his wife was successful, on appeal, in her claim under the *Wills Variation Act*, notwithstanding the terms of the separation agreement and the settlement she had received. The Court was prepared to review the settlement obtained by the wife in the context of what was fair and reasonable at the time of the testator's death.

Separation agreements and marriage agreements in general may include an obligation on the part of one or both spouses to re-make their will on re-marriage. According to Section 15 of the *Wills Act*, re-marriage will, in most cases, automatically result in revocation of a person's will. If a person contracts to re-make a will on re-marriage and does so, specific bequests or testamentary dispositions made, for instance, to the former spouse or children of the that person will be preserved.

If parties to a marriage agreement contract for certain provisions in a will and the will is subsequently revoked or otherwise modified, the surviving party to the agreement will have access to various remedies as set out above (*Pratt v. Johnson*, [1959] S.C.R. 102; *University of Manitoba v. Sanderson Estate* (1998) 47 B.C.L.R. (3d) 25 (C.A.)). In one case, the Court held that benefits received by the deceased's second wife in breach of a separation agreement with his first wife were impressed with a trust in favour of the first wife (*Fraser v. Fraser* (1995), 16 R.F.L.(4th) 112 (B.C.S.C.).

Again, many separation agreements and marriage agreements in general will have a clause which obligates the estate of a deceased spouse to uphold support obligations to either the former spouse, to children of the marriage or to both.

VII. CONSTRUCTIVE AND RESULTING TRUSTS

As previously stated, there is currently no legislation in British Columbia that deals with division of property between unmarried couples. However, once two parties enter into a property agreement under Section 120.1 of the *Family Relations Act*, their agreement is subject to review under Part 5 of the *Act* (the marital property provisions).

Where parties are not married and they do not have an agreement pursuant to Section 120.1 of the *Family Relations Act*, they may still claim an interest in property owned by the other spouse. This is done pursuant to principles of resulting trust or constructive trust. Again, these principles apply equally to both heterosexual and same-sex couples (*Anderson v. Luoma* (1986), 50 R.F.L. (2d) 127 (B.C.S.C.)).

A resulting trust is a trust implied in law from the intentions of the parties to a given transaction (*Black's Law Dictionary, 6th Edition*). For instance, there may be a finding of resulting trust in a situation where person A transfers property to person B or where person A transfers money to person B with which property is purchased in the name of person B but intended to belong to person A. If it is established that the parties intended, at the time of transfer, that the beneficial owner of such property was to be person A, there may be a finding of resulting trust in favour of person A.

In British Columbia, there is a presumption of advancement which applies to married couples in the context of the law of resulting trusts. The presumption of advancement is a concept whereby it is presumed that a transfer made between spouses is absolute, thus precluding a finding of a resulting trust (*Cole v. Cole*, [1943] 3 W.W.R. 532, affirmed [1944] S.C.R. 166 (S.C.C.)). In British Columbia, the presumption of advancement still exists however, it has been abolished in

many other provinces. The presumption of advancement no longer has the significance it once enjoyed (*Aleksich v. Konradson* (1995), 12 R.F.L. (4th) 177 (B.C.C.A.) and it does not apply as between unmarried couples (*Wilson v. Munroe* (1983), 42 B.C.L.R. 317 (S.C.)).

While the concept of resulting trust is still available to the courts in British Columbia, the more commonly applied trust is the remedial constructive trust. A finding of constructive trust is the legal remedy for a factual finding of unjust enrichment. Unjust enrichment can be found as between spouses and also as between other parties such as business partners.

The remedy of constructive trust was first accepted by the Supreme Court of Canada in a case called *Petkus v. Becker*. This case held that the remedy of constructive trust would be imposed in a situation where one party had been unjustly enriched at the expense of another. According to this case, a finding of unjust enrichment requires that there be an enrichment to person A, a corresponding deprivation to person B and the absence of any juristic reason for the enrichment (*Petkus v. Becker* (1980), 19 R.F.L. (2d) 165 (S.C.C.). While the law set down in *Petkus v. Becker* still applies in the family law forum, the Supreme Court of Canada has further expanded the law in this area more recently outside of the realm of family law (*Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217).

A resulting trust or constructive trust action may be the only remedy available to a spouse who seeks a division of property without a corresponding separation. In this scenario, there would be no "triggering event" as contemplated by the *Family Relations Act.* For example, where one spouse dies, the surviving spouse may assert a trust claim to the assets of the deceased spouse, whereas relief under the *Family Relations Act* would not be available. The remedies of resulting trust and constructive trust may also be pursued in a situation in which a spouse has missed the limitation period for bringing an action for reapportionment of family assets under Section 65 of the *Family Relations Act*.

Proposed changes to family law legislation include the addition of a Part 5.1 to the *Family Relations Act.* This Part would amount to a codification of the current law of constructive trust and would apply to couples living together in a marriage-like relationship for more than two and less than ten years (since Part 5 would apply to marriage-like relationships lasting ten or more years). This new Part 5.1 would make it easier for judges to apply the law of constructive trust and would likely result in more claims of this nature. Another change which may have a significant impact on common-law spouses will be the proposed changes to the *Wills Variation Act* which will allow claims by married parties, "domestic partners" (those who opt into a marriage-like status) and persons who live in a marriage-like relationship for more than two years.

VIII. CONCLUSION

This paper provides a brief overview of the family law considerations that apply to estate planning. Family laws change rapidly in British Columbia so it is necessary to always check the recent changes in the law before rendering an opinion, setting up a trust, or engaging in financial or estate planning.

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