Estate Planning for Blended Families

Over the last 50 years, the idealized post-Second World War family of two married parents, their 2.2 children and a pet all living together under one roof has ceased to become a reality for most people.

The advent of no-fault divorce in the 1970s and the increasing number of unmarried parents raising children has changed the modern family.

While not all traditional families get along, planning for blended families involves extra layers of complexity caused by different relationships within the family — the addition of a step parent and the "yours, mine and ours" sets of children.

While the instinctive response in second subsequent marriage situations is often to keep the wealth within family lines — what's mine is mine and what's yours is yours — this plan starts to break down when there are "our" children and/or when there is a significant disparity in wealth to which the lower-income family becomes accustomed. The longer that the relationship lasts, the more likely it is that different solutions will be preferred.

Some Statistics on Blended Families

- 16 percent of children in the US are living in a blended family — a household with a stepparent, step- or half-sibling.
- 63 percent of women in remarriages are in blended families.
- Less than half (46 percent) of children are living with two parents both in their first marriage.
- Hispanic, black and white children are equally likely to live in a blended family.

Source: Pew Research Center, The American family today, Dec. 17, 2015. Accessed on the web Oct. 24, 2019.

For most families, it is not just a question of finances and assets. Planning may be driven, particularly in the early years, by a mix of emotions and feelings that may be present depending on how the prior marriage ended.

Ages, wealth and children

Planning for the surviving spouse is simplified if the couple is married, particularly if the estate is potentially subject to estate taxes. This Advanced Markets Insight assumes that the husband and wife are married. The issues that have to be dealt with are the age differential between spouses (and children), differences in wealth and whether the couple have children together.

Age differential between spouses can be a reason for disharmony among the different family groups. Let's take the situation where Dad has remarried and the new wife is similar in age to the children from his first marriage. In this situation, let's assume that the wife does not have children (or significant assets) and that Dad and new wife will have a new family together. Wife has no relationship with Dad's children (they have probably never shared a home together) and these children are essentially strangers to her.

As a result, Dad's children may be estranged from Dad and the children may not be part of Dad's estate plan, and the new family may end up being the only beneficiaries of Dad's estate plan.

Planning for the spouse

Particularly if the new spouse is younger, there is a concern that family assets could end up benefiting a subsequent spouse. As a result, planning for the spouse usually employs a Qualified Terminable Interest Property (QTIP) style trust created during life or at death, although with the current increased estate tax exemptions it may not be necessary to actually qualify the trust for the marital deduction. The QTIP trust was created specifically for a second marriage situation: the spouse has limited rights in the trust during lifetime and the creator of the trust controls the disposition of the remaining trust assets at the death of the spouse.

The minimum requirement for a QTIP trust is that the spouse must be the only beneficiary during the spouse's life and must be entitled to all income at least annually. The trustee can be permitted to distribute principal to the spouse. Additional powers, such as a testamentary

limited power of appointment, can be given to the spouse but are unusual in this context.

One drawback with a QTIP trust is that it cannot terminate on the remarriage (or cohabitation) of the surviving spouse. If the assets are such that the trust is not required to qualify for the marital deduction, then this is not a problem. If this is a problem, then one solution may be to use an irrevocable life insurance trust with the spouse and other family members as beneficiaries, and qualify the annual premiums as annual exclusion annual gifts. As long as the insured had no incidents of ownership, this trust should not need to qualify for the marital deduction, and the interest of the spouse can terminate before death if certain conditions are met.

The other major planning issue for the spouse is the right to live in the marital home, usually as long as he or she remains unmarried, while the "ours" children are minors and the spouse is not living with a partner. This can be accomplished by having the house owned by a trust that enters into a rental agreement with the spouse.

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If the trust is a QTIP and the spouse remarries, then the right to live in the house can be terminated and the house sold in the trust. The spouse will generally continue to receive income for life on any proceeds generated by the sale.

Planning for the children

Planning for the children will often depend on their respective ages and the priority among "mine, yours and ours." A family or "B" trust can be created for this purpose.

This trust will generally be suitable if there is a desire to benefit the spouse at the same time while imposing restrictions on the amount that the spouse is to receive.

A family trust will allow distributions to the different families at different times and in different amounts according to the terms of the trust — "mine" and "yours" children, for example, could receive a specified amount at death of the parent while assets remain in trust for the benefit of the spouse and the children of a subsequent marriage.

The biggest planning issue for this type of trust is the choice of trustee. The trustee needs to be neutral when there is likely to conflict between the spouse and the different sets of children. A family member, or perhaps even worse a group of family members, acting as trustee may be seen as favoring the "other" side. A trust company may be the preferred choice as they get paid for dealing with family disputes.

Life insurance can be a key ingredient in planning for blended families. Besides providing protection for the spouse and a new family, life insurance can be used to provide for a first family at the death of the parent, leaving the remaining assets for the spouse and the new family. Using life insurance in this way will often mean that the first family will receive a legacy. If they have to wait until the death of the surviving spouse, any legacy may only be payable to the next generation.

Planning for special assets is a lot more complicated with blended families, especially if a family business is involved. Issues of estate equalization are magnified when equalization has to take place across different families as well as different branches of the family, and life insurance can be an essential part of providing family harmony.

Blended families are becoming a majority of family arrangements in America.[1] As this trend continues, it is important that planners become more familiar with these situations and the opportunities that they present. Life insurance presents a variety of planning opportunities for these families, and an opportunity that is not driven by the traditional estate planning need to pay estate taxes.

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1 Pew Research Center, The American family today, Dec. 17, 2015. Accessed on the web Oct. 24, 2019.

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