

Life Estates: Are they Still Useful?



By **Brian Madigan LL.B.**

Life estates were very popular estate planning tools until the 1960's when they fell into disuse. Typically, it was the husband who made a Will leaving the family home (registered in his name alone because he paid for it) to his wife for her lifetime, then to the children.

The trend towards women's rights and working women in the 1970's changed that perspective. However, the big motivation was the change in the taxation treatment in 1972. More frequently, we now have joint ownership, or even the wife (lower income spouse, or lower risk liability spouse) owning the property.

There are some **issues and concerns**:

- Who pays the mortgage
- Who pays for taxes, maintenance and insurance
- Will the life tenant and the capital beneficiary get along
- None of the beneficiaries have any money
- The property loses its principal residence exemption

It is always difficult to reconcile the allocation of costs and expenses as between the life estate and the future estate. These two categories are often referred to as the income beneficiary and the capital beneficiary. Sometimes there are issues as between the two classes of beneficiaries.

The answer 200 years ago would be quite clear. Property taxes, ongoing maintenance, and repairs would be the responsibility of the life tenant, and the mortgage payment would fall to the capital beneficiary.

It then occurred to some parties that the life tenant was getting something of a "free ride" on the mortgage. So, there were some cases allocating the interest portion of the mortgage payment to the life tenant and the principal payment to the capital beneficiary. However, even that was not entirely fair, so the decision was left to the Surrogate Court (estate court) to decide upon an appropriate allocation.

Today, the decision is somewhat discretionary. The common allocations are either two thirds/one third, or fifty/fifty. Who gets allocated the two thirds is a question of contention, and a decision by the Surrogate Court Judge as to who benefits the most. Oftentimes, the decision will be based on the length of time left

for the life tenant. How long is the life tenant going to have this property? And, then, of course, who will really benefit from the payment.

The ordinary allocation will be to the life tenant unless it can be demonstrated that the capital beneficiary (future estate) will indeed benefit in some material way.

Modern estate practice has evolved over the years and the allocation is usually specified in the Will (or trust document). The allocation is either specifically outlined or the Estate Trustee (Executor) will be given discretion to make the decision.

In fact, it would be solicitor's negligence not to deal with this issue appropriately.

Commonly, there is a provision for a fund to be set aside to be used to make these payments. This is a better estate planning approach. At present, the only type of life interest that would not be clear would likely be contained in a Will that was drawn by the Testator himself.

It still makes sense today for **cottage properties** and, it works in the case of a **second marriage**. So, once again, life estates are being used again as estate planning tools. They were all the rage in the 1200's because there were only estate taxes at the time and this was a great way to avoid them.

There are several items to note:

- Rarely is the property subject to a mortgage
- If there is a mortgage, often it is to be discharged out of other estate funds
- Absent some specific clause, the direction "to pay my just debts" requires the discharge of the mortgage
- There is likely a fund to pay for all expenses whatever they may be
- The property loses its principal residence exemption (this issue needs to be considered carefully, but doesn't apply to a second residence)
- The children usually don't have any funds for upkeep, so there should be another discretionary fund
- So, before we get to the wife's trust money and the children's trust money, we have probably already exhausted two separate funds set up for maintenance
- In this example, Judge's tend to favour the "poor" widow and will generally allocate 1/3 of any leftover expenses to her at the expense of the children

- This is of course fine as long as the “wife” is also the “mother” of the children
- If the “wife” is brand new, and 30 years younger than the children, this could be a problem and present its own issues

Nevertheless, the life estate as an estate planning tool is regaining its role as an effective estate planning tool.

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