NEWS IN BRIEF

PROVISION FOR STEP-CHILDREN

Step change

'Forever after' is no longer the norm for marrying couples. One in three marriages in England and Wales breaks down before the 15th anniversary, according to the latest figures from the Office for National Statistics – up from one-fifth of marriages in 1970. But this doesn't seem to put people off tying the knot;

34% of all marriages are between people where either one or both parties has been married before. For many of these couples, there will be children from the previous relationship, and they may also go on to have children together, meaning that family structures can get quite complicated. This can create estate planning problems which must be dealt with head-on.

When advising a client who has remarried, possibly with children and step-children, it is important to consider with the client their obligations to all of the children, as well as to their spouse. This can involve a delicate balancing act. Not only do the needs of the various beneficiaries have to be considered, there may also be a desire to do what is 'fair' in respect of the children. For some, this might mean treating all of their children and step-children equally; others may want 'their' estate to ultimately pass only to their own children after the couple have passed away. In some cases, there may be another parent who will provide for some of the children. It can quickly get complicated.

A client in this situation must also think carefully about the practicalities: will the remaining family members get on with each other and cope with whatever estate planning arrangements are put in place? Sadly, the glue holding the family together sometimes dissolves with the death of a parent, and relationships between step-children and step-parent can sour. Resentment will surface if there is a sense that the step-parent is delaying the children receiving their inheritance, or is frittering away the estate. Sometimes, a clean break can be better than step-parents and step-children being bound together for the foreseeable future under a complicated estate planning arrangement.

Failing to adequately provide for step-families could also lead to claims under the Inheritance (Provision for Family and Dependants) Act 1975 (IPFDA 1975). Ministry of Justice figures show that in the five years to 2013, there was a 700% increase in the number of High Court actions challenging provisions made in wills. Litigation is expensive and drives a wedge between family members, causing irreparable damage. Estate planning advisers have a key role to play in helping clients avoid these difficulties.

BALANCING THE INTERESTS OF A SPOUSE AND CHILDREN

For couples with children, the simplest estate planning will often involve the first deceased leaving everything to the surviving spouse, taking advantage of the spouse exemption from inheritance tax (IHT) and transferring the deceased's nil-rate band. The spouse can then make lifetime gifts to the couple's

children if it can be afforded and otherwise leave their entire estate to the children on death. However, where there are children from different relationships, there is no guarantee that the spouse will make the gifts whatsoever, or that all the children will benefit in the manner envisaged by the deceased. The spouse might prefer their own children and leave nothing to the step-children. They may remarry, bringing obligations towards the new spouse, too.

Where there are children from a previous relationship and a new spouse, the solution may lie in creating a life interest trust for the spouse under the will, providing income for the spouse and preserving the capital for the children. However, explaining the arrangements to the family is key to ensuring that all parties understand their rights and obligations, thereby reducing the risk of conflicts. The surviving spouse must understand that their entitlement is primarily to the income, and that the capital, as far as possible, will be preserved for the children; equally, the children must accept that they will have to wait for their inheritance. This can cause resentment and upset, particularly if the spouse seeks capital advances from the trustees.

One answer would be to leave the children something on the first death. However, gifts to children, unlike those to spouses, are not exempt from IHT, so it would be advisable to limit any such gifts to the deceased's available nil-rate band – unless the client considers that IHT is a price worth paying for family harmony!

There are, of course, tax and other cost implications to running a trust. A trust is taxed at the rate applicable to trusts – 45% for income and 28% for capital gains. Under the relevant property regime, a trust is subject to an IHT charge every 10 years, and there are also exit charges when funds are distributed between 10th anniversaries. Add to this, too, the charges of professional trustees and/or advisers. Consequently, a trust may only be attractive where the size of the estate and the nature of the competing potential beneficial interests warrant the expenditure.

Where a trust is used, the choice of trustees is critical. A client will often want their spouse to be a trustee along with their adult children, which seems fair. However, if the step-children and spouse are at loggerheads over the running of the trust, the testator's best intentions will be lost. Conversely, if a clause is included in the will allowing trustees to act by majority, the children could 'out-vote' the surviving spouse and – in the worst case scenario – terminate his or her interest. It is therefore sensible to include at least one independent trustee who will act impartially, and think carefully before including a majority clause.

The trustees will still have the difficult task of balancing providing for the spouse with preserving capital for the children. They will also have to consider how to divide the trust fund after the spouse's death. If the deceased only named their own children as potential beneficiaries, then this should be quite straightforward. If they included their step-children, then was an even split intended between all of the children, or are the testator's own children to be preferred? It is essential that a letter of wishes is left for the trustees, setting out the testator's wishes over the administration of the trust during the surviving spouse's lifetime and afterwards. Knowing what the deceased's wishes were can also help to ease any tensions which might otherwise flare up between the spouse and the step-children during the lifetime of the trust. If the deceased has conveyed their views to the family during their lifetime, then so much the better.

PROVISION FOR STEP-CHILDREN

Ensuring harmony between a spouse and step-children is one thing, but clients must also consider their duties and obligations towards their own step-children. Step-children may make a claim for a share of the estate under the IPFDA 1975 if they haven't been adequately provided for; section 1(1)(d) specifically includes as a potential claimant anyone treated as a child of a marriage or civil partnership. In addition, if the individual maintains a step-child then the child will be a potential claimant under section 1(1)(e) of the

IPFDA 1975. In a family where resources between parents are pooled and all of the children are provided for out of one 'pot', it is quite likely that parents will be maintaining their step-children to some degree. The starting point for the adviser must therefore be to ensure that under the will the step-parent makes appropriate provision for their step-children, as well as their own children.

Aside from that, step-parents should think carefully about the implications of treating their step-children differently from their own children under their wills. During a relationship, step-children are often treated on an equal footing with a step-parent's own children at home, and they might expect the same treatment after death. Conversely, children may anticipate preferential treatment to their step-siblings under their parent's will. It is not unusual for disappointed beneficiaries to challenge a will. Many beneficiaries see a will as a measure of the deceased's love and affection, rightly or wrongly, and that disappointment can quickly turn to conflict. However, there is often a simple explanation, such as the fact that the step-child will inherit from another parent and so has been left less. The solution could therefore be as simple as the client communicating their wishes to the family, either by speaking to them or leaving a letter of wishes to be read after death. If everyone knows where they stand, there is far less cause for upset.

WE NEED TO TALK

Central to all of this is the need for the couple to discuss between themselves what they want to happen to their estates after both of them have died. Will each pass 'their' assets to their own children, or will they divide their combined estates between all the children and step-children? Whatever they agree, they must ensure their wills dovetail, so their wishes are carried into effect on death. They must also keep the arrangements under review, regularly update letters of wishes, and consider discussing their plans with family members once the children are older.

The couple should also take into account life insurance policies, death-in-service plans and pension death benefits which may have been written in trust. These can be very valuable, sometimes more so than the estate. Advisers should check whether step-children ought to be included in the class of beneficiaries, and ensure that up-to-date letters of wishes are left, offering the trustees appropriate guidance over distributions.

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