

# Your Guide to Estate Planning



Live *your* dream.



# Table of Contents

---

Objectives.....	2
Points to Consider .....	2
Think of your Family .....	3
Estate Planning for Family Business Owners .....	3
<b>Maximize the Value of your Estate.....</b>	<b>3</b>
Pay off Personal Debts .....	3
Save for your Retirement .....	3
Split Income with Family Members .....	4
Consider Disability Insurance.....	4
Protect your Assets from Creditors .....	4
Power of Attorney .....	4
Family Law Considerations .....	5
<b>Minimize Tax on Death.....</b>	<b>5</b>
Income Tax .....	5
Strategies to Reduce Income Tax.....	5
Claims Capital Gains Exemptions.....	5
Give to Charity .....	6
Prearrange your Funeral.....	6
<b>Income Tax Deferral Strategies .....</b>	<b>7</b>
Use and Estate Freeze .....	7
Probate Fees and U.S. Estate Tax.....	8
Probate Fees.....	8
U.S. Estate Taxes .....	9
<b>Transmitting your Estate .....</b>	<b>9</b>
Wills .....	10
Life Insurance.....	10
<b>Other Strategies.....</b>	<b>11</b>
Testamentary Trust in Your Will .....	11
Estate Freeze for your Beneficiaries .....	11
Wind up your Holding Company.....	11
Maximize Tax Deductions and Credits.....	12
Summary .....	12

# Your Guide to Estate Planning

Like most people, you have definite goals, both personal and financial. However, without a plan to focus your efforts, you may find it difficult to achieve them.

One area that you should examine closely is your estate. Since estate planning is a wide-ranging subject, you need to concentrate on the various components of a good estate plan and how they apply to your situation and goals. Once you've considered the topics we are

Since estate planning is a wide-ranging subject, you need to concentrate on the various components of a good estate plan and how they apply to your situation and goals.

going to introduce, you can begin the process of establishing an estate plan that makes sense for you.

Even if you already have a plan, keep reading—estate planning is a continuing process. At different stages of your life, your situation and goals will change, and you may

decide to amend your strategy. You have to constantly monitor a plan to ensure that it is still relevant for you.

## Objectives

Simply put, the goal of estate planning is to:

- Maximize the value of your assets, including the preservation and protection of property during your lifetime
- Minimize and defer tax and other costs arising on your death
- Allow for an orderly transition of assets to your beneficiaries

- Provide for your dependants, which can include decreasing their taxes where possible.

You will likely have other intentions. For example, you may want to leave specific assets to certain beneficiaries while treating all of them fairly. Or, you may want to make a sizeable gift to charity upon your death. Due to the wide variety of possible objectives, estate planning has often been described as an art rather than a science, but a few general rules apply to everyone.

## Points to Consider

Some of your goals may be at odds with others. If most of your net worth is invested in a family business, it may be difficult to treat all children equally if you transfer your business to one child as your successor. Although minimizing tax is one of your chief objectives, you also have to make sure tax minimization strategies do not conflict with your other wishes. Estate planning is a balancing act—you'll need to evaluate the conflicting issues and choose an arrangement that makes the most sense for you. Ultimately, an effective estate plan will address as many of your individual goals as possible.

When developing your estate plan, don't focus only on your beneficiaries; think about yourself and the income and assets you'll need to enjoy the lifestyle that you want. A good plan will ensure that you have saved adequately for your retirement, either by contributing to your Registered Retirement Savings Plan or other pension plans or through other savings. You don't want to decide to give away assets and realize later that you really need them for yourself.





*Live your dream.*

## Think of your Family

Your family should not have to cope with potentially difficult legal and tax matters upon your death. A good estate plan will help them deal with your estate at a difficult time. They will have enough to handle when the time comes—so make major decisions prior to death.

One final thing to keep in mind is the importance of discussing your intentions with your family. Too many people assume that the family understands their goals and objectives concerning their assets. Estate planning works best when your family is aware of your wishes and understands the reasons for your decisions.

## Estate Planning for Family Business Owners

If you own a business and intend to turn it over to your children, additional planning will be involved. You are not only passing on ownership of the business, but also providing for management succession. Generally speaking, unless you plan ahead for succession, your business will not maintain its value when ownership passes to your heirs. In some cases, the business may not even survive, or it may have to be sold.

You can take several steps to maximize the value of your estate, increase the net cash that flows to you, and minimize possible threats to your estate. We are going to describe simple strategies to make the most of your estate during your lifetime.

## MAXIMIZE THE VALUE OF YOUR ESTATE

### Pay off Personal Debts

If you're like most people, you have to borrow to buy an expensive asset such as a house. One of your first goals should be to pay down these debts. From a tax perspective, this is an excellent way to save money.

Let's assume you have a \$100,000 mortgage at a 10% interest rate (to simplify matters we'll ignore compounding interest). At the end of each year, you have the option of paying off 15% or \$15,000 of the principal. If

you make the extra mortgage payment, you will reduce your interest costs in the next year by 10% of \$15,000 or \$1,500. If you invest the \$15,000 in a term deposit that earns interest at 10% instead of paying down your mortgage, you will also earn \$1,500 in interest.

What's the difference? Since the mortgage was taken out to buy a non-income-producing asset (your home), you can't deduct the interest expense for tax purposes. If you pay down your mortgage and save \$1,500 in interest costs, you'll be \$1,500 ahead at the end of the year. However, if you earn interest on a term deposit of \$1,500, you will have to pay tax on this income. If your marginal tax rate is 50%, you'll really have

only earned \$750 of interest after taxes. You would have had to earn interest at a rate of 20% or \$3,000 on your term deposit to put you in the same after-tax position.

Properly managing personal debts is one of the best ways to build your estate when you are acquiring assets. Be vigilant about paying off these debts as quickly as possible.

### Save for your Retirement

It's never too soon to begin saving for your retirement. The earlier you start the more money you will have to enjoy when you stop working. In addition, properly funding your retirement will increase the value of your estate to be passed on to your family.

The Canadian tax system allows you to save for your retirement on a tax-deferred basis, either through a pension

The earlier you start the more money you will have to enjoy when you stop working. In addition, properly funding your retirement will increase the value of your estate to be passed on to your family.

plan at work or through your own Registered Retirement Savings Plan (RRSP). Not only are the contributions to these plans deductible for tax purposes, saving you taxes now, but the income earned on contributions is not taxed until you withdraw them from your plan—which may not be for many years. These rules make pension plans and RRSPs the best tax shelters in Canada.

Take full advantage of your pension plan or RRSP to save for your retirement.

### **Split Income with Family Members**

The more tax you can save, the faster you will build the assets in your estate. Splitting income with family members who have lower marginal tax rates than you will

Once you have maximized your estate, the next step is to ensure the tax on it is minimized.

help reduce your income taxes.

Income splitting can be as simple as your spouse saving the money while you pay all the family expenses (assuming your spouse

has a lower marginal tax rate). Or, if you are already retired, you can elect to split CPP benefits with a lower-income spouse. More sophisticated plans could involve the use of a family trust.

### **Consider Disability Insurance**

What would happen if you suddenly became permanently disabled due to an accident? Would your family have the resources to take care of you? Would the loss of your income mean undue hardship for your family, or wipe out the estate you intend to pass on?

Many employees have some form of disability insurance through work, usually structured so that any disability payments received would not be taxable. However, if you are a self-employed contractor, or have your own business, you may not have considered the financial consequences of becoming disabled. Think about disability insurance if

you are not currently covered.

You should determine the level of coverage you'll need in order to provide a sufficient level of income should something happen to you. Read the fine print carefully, as not all disability policies are the same. For example, does the policy cover situations where you can no longer perform duties in your chosen occupation, or does it simply apply to situations where you are unable to work in any occupation?

### **Protect your Assets from Creditors**

While it's difficult to fully creditor-proof your assets, you can take some steps to protect them from possible claims. For example, RRSPs held with life insurance companies may be safer from creditor claims than RRSPs held with other institutions such as banks. The rules vary from province to province.

### **Power of Attorney**

What happens if you lose the ability to manage your affairs and make important decisions? Who will take charge? You may be surprised by the answer. Although your assets will be protected, there will be a cost associated with dealing with the legal issues. Moreover, as the legal issues are resolved, important financial decisions may not be made on a timely basis.

By drafting a power of attorney, you can choose the person who is best qualified to manage your affairs should you become mentally incapacitated. A power of attorney gives written authority to this person to deal with your estate on your behalf.

If you don't have a power of attorney, provincial laws govern who is responsible for managing your affairs. Although interested parties can generally apply to the courts to be granted the right to conduct your affairs, this process can be time-consuming and expensive. For example, in Ontario, a relative has to apply to the office of the Public Guardian and Trustee for the Province of Ontario to become a person's legal guardian. Therefore, don't assume family members can act on your behalf on



*Live your dream.*

short notice. If you don't have a power of attorney, speak to your lawyer about putting one in place.

## Family Law Considerations

Do you have significant assets and are about to marry or remarry? If so, it is important to understand the family law rules that apply in your province. In many cases, a division of assets will be required in the event of marriage breakdown.

One way to reduce uncertainty and ensure your assets are dealt with fairly for all concerned is a marriage contract. A marriage contract allows you and your spouse to agree beforehand on how your assets will be divided in the event of a marriage breakdown. For business owners and individuals with children from a previous marriage, this can be extremely important.

In some provinces, family law can override the rules for property division contained in your will. Consequently, a marriage contract can also help ensure that your estate is divided as you intend on your death. Consult your lawyer to determine if you should consider a marriage contract.

## MINIMIZE TAX ON DEATH

Once you have maximized your estate, the next step is to ensure the tax on it is minimized. Two basic types of tax can apply on your death: income tax and taxes based on the value of your estate, such as U.S. estate tax and probate fees. In the rest of this section, we will discuss how these taxes are incurred and steps you can take to reduce, or at least defer, these costs.

### Income Tax

Upon death, an individual is deemed to have disposed of most assets for tax purposes at their fair market value. For capital property, this means that all accrued capital gains will be taxed. If you own depreciable property such as a rental property, depreciation you claimed in the past will be included in your income, assuming that the current fair market value of the property exceeds its original cost. The value of RRSPs and Registered Retirement Income Funds

(RRIFs) is also generally included in an individual's income on death.

For most people, the tax arising on these deemed dispositions will represent the largest tax cost on death. Consequently, one of the main goals of estate planning is to minimize these taxes where possible. Once you've minimized the tax bill, the next step is to try to defer its payment as long as possible.

### Strategies to Reduce Income Tax

Tax plans for dealing with taxes arising on death usually fall into two categories: plans that reduce tax and plans that defer tax. There are a number of ways you can reduce taxes that will arise on your death.

#### Claim Capital Gains Exemptions

Although the \$100,000 capital gains exemption was eliminated in 1994, the \$500,000 exemption for shares of qualifying small business corporations and qualifying farm property is still available. Note that the \$500,000 exemption is reduced by amounts previously

claimed under the general \$100,000 exemption. If you own this type of property, there are two basic ways of using the exemption. First, your executors can simply claim your remaining exemption against capital gains that arise on your death. However, there may be problems with this plan:

- The property may not qualify at the time of your death.
- There is no guarantee that the exemption will always be available.

For most people, the tax arising on these deemed dispositions will represent the largest tax cost on death. Consequently, one of the main goals of estate planning is to minimize these taxes where possible.

Consequently, you should consider the second option for using your exemption—a crystallization of some or all of your gain. Crystallization involves triggering a disposition of one or more qualifying assets with accrued capital gains for tax purposes. Any capital gain reported in your tax return will be offset by a capital gains exemption claim, meaning that you will generally not have any tax to pay. The benefit of the exemption will be realized in the future when you dispose of the asset, as it will now have an increased cost base for tax purposes. This will reduce the capital gain you have to report on the actual disposition.

### **Give to Charity**

A gift to charity included in your will (referred to as a charitable bequest) can reduce income tax arising on your

Income tax can usually be deferred by transferring assets to family members or other beneficiaries who are younger than you, as they will also face a deemed disposition of their assets on death.

death. Before dealing with the tax rules that apply specifically to charitable bequests, it is important to understand the basics. Charitable donations made by individuals are eligible for a non-refundable federal tax credit. The first \$200 of donations is eligible for a 17% non-refundable credit while

the excess over \$200 is eligible for a 29% credit. Provinces and territories also offer tax relief, either as separate credits, or due to the fact that provincial/territorial tax is based on federal tax. As a result, the actual tax savings from charitable gifts will vary by province or territory.

There are rules that limit the amount of donations you can claim during the year. Your donation claim will generally be limited to 75% of your net income for the year in which you make the gift. If you gifted capital

property, you may be able to claim an additional credit amount, which will ensure that any tax from a taxable capital gain and recapture of depreciation that arose from that gift can be offset by a donation credit. If you make a large donation in a particular year and are unable to claim the full amount, the unclaimed portion can be carried forward and claimed in the following five taxation years.

Due to the limitations on donation claims and the fact that donors must ensure that they provide for themselves and their family, many choose to wait and make large gifts under the terms of their will as a charitable bequest. To assist people making these gifts, the government has provided the following special rules for bequests and other gifts made in the year of death:

**One-year carry back** - Donations made in the year of death can be carried back and claimed in the prior year. This rule is especially useful where income in the year of death is low.

**Income limitations waived** - In the year of death and the previous year, the 75% net income limitation will not apply. Your donation claim can be up to 100% of your net income, which will be more than enough to eliminate your income tax.

**Charitable bequest carry back** - If you provide for charitable bequests in your will, the actual gift will be made sometime after your death. However, if certain conditions are met, your executors can claim this gift in the year of death on your final tax return. Using the general one-year carry back rule above, the bequest can also be claimed in the year prior to death.

### **Prearrange your Funeral**

Although not a pleasant topic, arranging for your funeral before you die will relieve your family of having to deal with these details at a difficult time. You will also be able to obtain a modest tax saving. You can provide a funeral home up to \$15,000 for funeral services or \$20,000 for cemetery services on deposit towards the





*Live your dream.*

cost of the funeral, and the investment income earned on these funds will not be taxable to you. Where the funeral home is providing funeral and cemetery services, the limit is \$35,000 in total. In fact, if the investment income is eventually used for cemetery or funeral services, it will never be taxed.

Note that if the funds are returned to you, or if your estate receives a refund from the funeral home because the amount on deposit exceeded the funeral costs, these amounts will be taxed to the extent that investment income was earned.

## INCOME TAX DEFERRAL STRATEGIES

After you have minimized the potential tax cost, your next priority will be to try and defer this cost as long as possible.

Income tax can usually be deferred by transferring assets to family members or other beneficiaries who are younger than you, as they will also face a deemed disposition of their assets on death. A tax rollover will provide the largest deferral, as both past and future gains will be taxed in the hands of your beneficiaries. In the case of deferred income plans such as your RRSP, your beneficiaries will pay tax on amounts withdrawn from the plan if a rollover is available.

Since tax rollovers are limited, you'll want to take full advantage of the ones that are available:

**Transfer assets to a spouse** - If you leave assets directly to your spouse or to a trust for the benefit of your spouse under the terms of your will, you will be deemed to dispose of these assets at their tax cost. In addition, funds held in RRSPs, RRIFs, and Registered Pension Plans (RPPs) can be transferred to a plan for your spouse on a rollover basis.

**Transfer farm property to a child or grandchild** - If you own farm property, tax can be deferred if the property is left to a child, grandchild, or great-grandchild. Many conditions must be met to qualify for this rollover; such

as, the land must be in Canada and used in farming by you (the deceased), your spouse, or your children, grandchildren, or great-grandchildren immediately before your death. However, if the conditions are satisfied, you will be deemed to dispose of the property at your tax cost on your death. Your beneficiary will have the same tax cost. This rollover allows tax on this property to be deferred one or more generations.

**Transfer your RRSP to an infirm child** - If you have a child or grandchild who is financially dependent on you due to a physical or mental disability, the balance of your RRSP or RRIF may be transferable to an RRSP or life annuity for the child upon your death.

### Use an Estate Freeze

Where a tax rollover isn't available, you can still take advantage of a common tax planning technique known as an "estate freeze" to ensure future gains will be taxed in the hands of your heirs. An estate freeze is a process where you guarantee that the future growth of your estate accumulates in the hands of your beneficiaries. By freezing the value of your estate, you will effectively lock in the tax that will arise on your death (subject to changes in tax rates in the future). An effective estate freeze will allow you to pre-determine the taxes that will arise on your death so that you can ensure that cash will be available to pay that tax (for example, by taking out sufficient life insurance).

You can transfer the assets you wish to freeze to a trust whose beneficiaries would be your intended heirs. This will allow future growth to accrue to them without giving them control over your assets.

There are many ways to accomplish an estate freeze. One is to transfer the assets you wish to freeze, such as shares of your business, to a corporation. By taking back fixed value shares, the transfer of assets to the corporation can be accomplished on a tax-deferred basis using special rollover provisions in the tax rules. Your beneficiaries can then subscribe for the common or growth shares of the company. At the time of the estate

Once you have taken steps to maximize the value of your estate and reduce the taxes payable on it, you want to ensure that your estate is passed on to your heirs in accordance with your wishes.

freeze, the value of these common shares would be nominal, but the growth in value of assets in the company would attribute to the common shares. You could continue to control the assets in the company by ensuring that your fixed value shares will always be able to outvote the common shareholders.

You can also freeze your estate by using a family trust. Under this alternative, you can transfer the assets you wish to freeze to a trust whose beneficiaries would be your intended heirs. This will allow future growth to accrue to them without giving them control over your assets.

The major difference between using a family trust and a corporation for an estate freeze is that it will not be possible to transfer property to the trust on a tax-deferred basis. Tax will have to be paid on any accrued gains on the assets at the time of the transfer. However, if accrued gains are small, a trust may be advantageous, as assets held in the trust will not be subject to the deemed disposition rules that apply on death. It should be noted however, that assets held in family trusts are subject to a deemed disposition every 21 years.

Before undertaking an estate freeze, you should carefully consider whether you would have enough assets to live on without the future growth of the frozen assets. It may not be possible to reclaim your assets after a freeze.

### **Probate Fees and U.S. Estate Tax**

In addition to income tax, other taxes can apply on death including probate fees (which are a form of taxation according to a recent decision of the Supreme Court) and U.S. estate tax. Unlike income tax, these taxes are based on the value of your estate and not accrued gains. However, with planning, it is possible to reduce the effect of both taxes on your estate.

### **Probate Fees**

Probate fees have to be paid to a province when a court confirms the validity of a will. Planning to reduce probate fees has become especially important in B.C. and in Ontario given the recent increases in provincial probate fees. If you need a probated will to transfer ownership of one asset referred to in the will, the value of all assets referred to will be subject to probate fees. Except in Ontario and B.C., these fees are usually relatively minor. However, both B.C. and Ontario charge a fee based on the value of the assets with no upper limit. In Ontario, the top rate is 1.5% while in B.C. the top rate is 1.4%.

There are several techniques to reduce probate fees. If you name a direct beneficiary for your RRSP, RRIF or insurance policy, the proceeds payable on death will go directly to that person rather than passing through your estate and therefore avoid being subject to probate. Probate can also be avoided on assets that are held jointly with rights of survivorship with other persons such as your spouse or children. Again, ownership of the property passes directly to them when they die.

More sophisticated planning techniques are also available. Examples include Ontario residents using two wills—one covering assets that require probate and one



*Live your dream.*

covering assets that do not require it.

Under proposed tax changes, rollovers are now allowed to certain trusts. Where assets are held in these trusts at the time of death, the assets do not form part of your estate, and are therefore not subject to probate fees. It should be noted that these trusts will have a deemed disposition for income tax purposes on your death, so these trusts should not be used for an estate freeze.

You should keep in mind that probate fee planning is only one aspect of an estate plan. You may have other goals that will mean incurring more probate fees than you would like. For example, using probate fee reduction techniques to exclude assets from your estate will usually reduce the amount of assets available for testamentary trusts. The tax planning value of the testamentary trusts can greatly exceed the probate fees saved.

## U.S. Estate Taxes

If you own U.S. property, you should be aware that the U.S. imposes a tax on estates. When U.S. residents and citizens die, they are subject to an estate tax based on the value of their worldwide estate. However, even if you're not a U.S. citizen or resident, you may still be subject to U.S. estate taxes, based on the value of your U.S.-situs property.

U.S.-situs property includes real estate (e.g. Florida condominiums), personal property located in the U.S. (such as boats and furniture), and U.S. stocks and bonds (even when held through a Canadian brokerage account).

A protocol to the Canada-U.S. tax treaty alleviates U.S. estate tax concerns for many Canadians. Generally, the protocol will mean that Canadians with smaller worldwide estates (less than \$675,000 U.S. for 2000, increasing to \$1,000,000 U.S. by 2006) do not have to worry about U.S. estate taxes. However, if the value of your worldwide estate exceeds this amount, and you own U.S. property, your estate may be subject to U.S. estate tax, even if the value of your U.S. property is low in relation to the value of your entire estate.

There are planning opportunities available to reduce your exposure to U.S. estate taxes on your death.

## TRANSMITTING YOUR ESTATE

Once you have taken steps to maximize the value of your estate and reduce the taxes payable on it, you want to ensure that your estate is passed on to your heirs in accordance with your wishes. Although a number of issues will need to be reviewed and dealt with, two major problems can come up:

- If your instructions are not clear and legally effective, your assets may not pass to your intended heirs. The best way to ensure that these uncertainties don't arise is to have a properly drafted will.
- Even with timely planning to reduce and defer income taxes and other costs, there will be costs that your executors will have to pay after your death. Therefore, unless there is enough cash available after

Life insurance is an important part of many estate plans, and can be used for a number of functions. You may use existing insurance for different purposes as you proceed through different stages of your life.

death, your executors may have to sell some or all of your estate assets to pay these costs. To avoid this, you should ensure that there is enough cash available after death to pay these costs. For many people, the best solution is life insurance.

## **Wills**

You can transfer your assets to your heirs in several ways. For those interested in reducing probate fees, assets can be transferred by way of a gift or a transfer to certain inter-vivos trusts. Another option is to transfer title to assets to joint ownership. However, each of these transfers can involve giving up control over an asset, either in whole or in part and can trigger an immediate disposition of the asset for income tax purposes. Because of this aspect, most people transfer assets to their heirs by a will. This allows you full control and the use of your estate during your lifetime.

A will is a legal document that contains instructions to carry out your wishes on your death. This document determines who will receive your assets, how and when the amounts will be paid, and any other instructions important for an orderly distribution of your estate. If you have minor children, your will is the best place to clearly set out your wishes as to who should be their guardian.

Every adult should have a will. If you die without a valid will, you will have died "intestate." This means that the court must appoint someone to administer your assets. If you do not have any next-of-kin, the courts may turn your estate over to provincial authorities. Even where you do have next-of-kin, it is unlikely that provincial estate division rules will match your wishes.

A key decision you need to address when drafting your will is the choice of an executor to carry out your wishes. Although many people feel obliged to appoint a family member as executor, you need to ask yourself if that person will have the ability to carry out the duties required. In many cases, acting as an executor can be a large undertaking, and the responsibilities will arise at a difficult time.

Finally, it is important to consult your lawyer when drafting a will. A lawyer will help you ensure that your will is valid and will carry out your wishes. He or she will also make sure that it is consistent with the Family Law Act in

your province, to avoid any challenges to your will after your death. In some jurisdictions, family law can override provisions in your will.

## **Life Insurance**

Life insurance is an important part of many estate plans, and can be used for a number of functions. You may use existing insurance for different purposes as you proceed through different stages of your life.

**Protection for Your Family** - Generally speaking, individuals first buy insurance as protection for members of their family. For example, you may want to ensure that you have sufficient life insurance to pay the mortgage on your home so that your family will not have to give up their home if you die.

**Building an Estate** - Once their children are older, many individuals continue to hold insurance as a means of building their estate. On your death, the proceeds of the policy can benefit a specific beneficiary or can be made payable to your estate, to be distributed in accordance with the instructions in your will. In many ways, a life insurance policy can be considered to create an "instant estate" on your death.

**Funding Tax Liabilities Arising on Death** - Later in life, funding tax liabilities that will arise on your death may become significant, especially if you own a business. If your executors do not have sufficient funds to pay these taxes, they may be forced to sell your business to pay the taxes arising on your death. Life insurance is valuable in these situations, as it provides a source of funds to pay this tax cost, and the receipt of the insurance by your executors will generally be tax-free. If you've performed an estate freeze, you will be in a good position to estimate the taxes that will be triggered and how much insurance you'll need.

**Funding Buy-sell Agreements** - If you carry on business with others outside your family, you may be required to buy the interest of your business associates on their death,



*Live your dream.*

or your executors may be required to sell your interest when you die. Again, life insurance is a valuable tool that can be used to fund these buy-sell agreements. Insurance will ensure that the business will have enough funds to buy out the estate of you or your partners with minimal disruption to the business.

You should regularly evaluate your insurance needs to ensure that you have the policies in place that are appropriate for you.

## OTHER STRATEGIES

Earlier, we discussed methods you can use to minimize taxes arising on death, but there are some additional techniques that your executor and family can use to reduce or defer tax after your death.

### Testamentary Trust in Your Will

A testamentary trust is a trust that is created on the death of an individual, under the terms of the deceased's will. It's taxed much in the same way as an inter-vivos trust, with two major and beneficial exceptions.

First, where income is taxed in a trust, tax is generally payable at the top federal and provincial personal tax rates. However, a testamentary trust pays tax using the marginal rates available to individuals. If members of your family will be in the top personal tax bracket, a testamentary trust can provide significant savings. In addition, the savings can be multiplied, as you can set up an individual testamentary trust for each of your children.

As an example, let's say you set up a testamentary trust for a child who is in the top tax bracket and the trust earns income of \$60,000 per year that would otherwise be taxable to the child. Depending on which province your child lives in, the tax savings will be between approximately \$6,400 and \$8,500 a year, when you compare the tax payable by the trust with the tax your child would pay personally on that income.

Testamentary trusts can also offer a timing advantage.

Unlike other trusts and individuals, a testamentary trust can

have a non-calendar taxation year. This can be beneficial where income of the trust is allocated to a beneficiary. When the income is paid or payable to a beneficiary, the income is taxable to the beneficiary in the calendar year in which the trust's taxation year ends.

For example, let's assume that a testamentary trust has a January 31st year end. If a dividend is received by the trust in February 2007, that dividend will be included in the trust's tax return for the taxation year ending January 31, 2008. If the trust allocates the dividend to a beneficiary, that income will be taxed in the individual's tax return for 2008, and tax on that income won't be due until April 30, 2009—more than two years after the income was received.

### Estate Freeze for your Beneficiaries

If your children have children, they may also want to perform an estate freeze, particularly if they will receive property from your estate. As discussed earlier, you will be deemed to dispose of most assets on death at their fair market value, and therefore, your beneficiaries will have a high tax cost when they inherit the asset. If a freeze is performed shortly after your death, your beneficiaries can ensure that gains accruing in the future will be taxed in the hands of your grandchildren.

### Wind up your Holding Company

If you own shares of a company, and the assets of the company are composed primarily of marketable securities and cash, the potential for double-taxation should be addressed in your estate plan. The problem is related to the fact that there are two ways of realizing the value of a corporation from a tax point of view. First, if you sell the corporation (or are deemed to dispose of it on death), the accrued gain is taxed as a capital gain. However, if you



decide to liquidate the company's assets and wind up the company, the net gain is generally taxed as a dividend.

If you hold shares in a holding company at death, capital gains will owe on the shares, and your heirs will take over the company with a higher tax cost. However, if your children decide that they want to realize the value of the holding company in cash, it is unlikely that they will find a buyer for the company's shares, and they may wind it up. Double tax can arise since your children will realize a dividend on wind-up. Although they will get credit for the high cost of the shares as a capital loss, this loss can only be used to reduce capital gains. Consequently, even though capital losses can be carried forward indefinitely, if your children don't earn capital gains in the future, they may not benefit from this loss.

There is a solution to this problem. However, communication with your family is important. If your children intend to wind up the company, you should ensure that the holding company is wound up while the shares are still held by your executor (during the first year of the estate). Where a deceased individual's estate realizes a capital loss in the first taxation year following death, that capital loss can be carried back to offset capital gains arising on the deceased's final tax return. To ensure that this liquidation is done on time, it is advisable to put instructions in your will to ensure that the wind-up is done on a timely basis.

### **Maximize Tax Deductions and Credits**

When tax returns are prepared for deceased taxpayers, a number of rules can be used to lower taxes payable by the estate, which includes:

Elections to include income on a separate return - In addition to the last regular tax return for a deceased individual, there are additional elective returns that can be filed. The most common of these elective returns are a return for rights and things receivable, and a trust return

to report income while a deceased individual's estate is under administration.

A right or thing is an income item that is due to a taxpayer, but is not received until after death. A common example is an unpaid dividend that was declared before a shareholder's death. In addition, even if you do not provide for an ongoing trust under your will, it may be possible to file a trust return to report income earned by your estate as a testamentary trust. Elective returns provide an advantage, as tax is calculated on each return using a separate set of marginal rates, and in the case of elective personal returns, additional tax credits are allowed.

Ensure that an exemption is claimed for death benefits received - When a benefit arises due to the death of an employee, the first \$10,000 of the benefit is not subject to tax.

### **Summary**

Estate planning is important, no matter at what stage of life, and we have touched on a number of issues we think you should consider. Remember that as you grow older, your needs and goals will change. Therefore, your plan will also have to be modified. Estate planning is not static—constantly review your strategy to make sure that it continues to be relevant for you. Talk to us now to determine what action you should be taking.





[www.ipcc.ca](http://www.ipcc.ca)

#### MEMBERS OF INVESTMENT PLANNING COUNSEL

---



<sup>TM</sup>Trademarks owned by Investment Planning Counsel Inc. and licensed to its subsidiary corporations. Investment Planning Counsel is a fully integrated Wealth Management Company. Mortgage broker services provided by IPC Save Inc. (ON Lic. #10227). Mutual Funds available through IPC Investment Corporation and IPC Securities Corporation. Securities available through IPC Securities Corporation, a member of CIPF. Insurance products available through IPC Estate Services Inc.