You can't take it with you

WILLS **EXPLAINED**

A Will is an essential part of an estate plan, but what many people don't understand is why. A Will is what speaks for you after you pass away. It communicates your intentions and allows you, and not the government, to determine how the assets that you have worked a lifetime to accumulate will be distributed upon your death.

A Will facilitates the administration of your estate, can save you taxes, and avoids the potentially severe consequences of dying without a Will (also known as dying "intestate"). Yet, despite its importance, it is estimated that only about one half of all Canadians have a Will. This is alarming when one considers the benefits a Will can provide and the relatively modest cost of drafting a Will. We work hard to acquire our wealth, so doesn't it make sense to spend a little effort to make sure that it is not all frittered away?

What is a Will and why do you need it?

A Will is a formal document that sets out how your assets are to be distributed on your death. It also allows you to designate who should take care of your children should both you and your spouse pass away.

More specifically, the Will designates the person (the "executor") or institution that will administer the estate, to whom the assets are to be distributed, and when and how the distributions are to be made. The Will can also include special provisions for minor and disabled beneficiaries, and can specify whether certain debts owed to the individual are to be repaid or forgiven.

Generally, a Will can be updated either through the use of a Codicil (a testamentary document that makes one or more changes to a Will) or a new Will. In addition, a Will must be revocable – that is, the testator (person making the Will) must always have the ability to amend or revoke the Will if they so choose.

Having a well drafted Will can minimize the cost and delays of administering the estate, reduce or postpone taxes, and reduce the issues that grieving relatives and friends must deal with at the time of the death of a loved one.

What if I don't have a Will?

If you don't have a Will or your Will is deemed to be invalid, you will be deemed to have died intestate. Generally, the court will appoint someone to administer and distribute your estate according to the provincial intestacy laws, regardless of what your wishes are. This means that your assets may not be distributed to the beneficiaries as you intended.

Under the intestacy rules, your spouse will usually receive a certain amount of your estate (often known as the "preferential share") and the remainder will be divided between your spouse and children. This may not seem problematic, but it can lead to undesirable results.

We work hard to acquire our wealth, so doesn't it make sense to spend a little effort to make sure that it is not all frittered away?

Take the situation where spouses are separated and estranged. Because they haven't divorced, they are still technically spouses, which means that the intestacy rules require that all or part of their estate be distributed to the separated spouse. You should also consider the situation with minor children. Portions of an estate payable to a minor child are usually paid into court until the child reaches the age of majority. This means that at the age of 18 (this varies from province to province) a child could take their full entitlement. For many people, this is not what they want.

Intestacy may also result in more taxes being paid leaving less money for your family. The distribution of assets is often much slower and more expensive with intestacies, which can make the whole process frustrating for your loved ones at a time when they are already grieving your loss.

Preparing your Will

There are several do-it-yourself Will planning kits available, however it is generally recommended that you instead retain the services of an experienced lawyer. Wills must satisfy certain technical requirements and one must anticipate and provide for all possibilities. If a court does not agree with the way you have prepared your Will or if parts of it are unclear, it may decide to change the Will or even declare it invalid. Each province has its own laws regarding Wills and your legal advisor will ensure that yours meets these requirements. Besides, the cost of a Will is usually very reasonable.

Preparing a Will involves several steps. First you should make a list of your assets, for example, your home, car, cottage, business interests, life insurance, investments etc. You'll need to review the ownership of these assets. Do you own them solely or jointly? For life insurance policies or registered plans (such as RRSPs or RRIFs), is there a beneficiary named within the contract?

You should consider how your estate will be divided, and who will get what. If done properly, this should include an estimate as to the size of your estate and the taxes owing on your death.

Careful thought should also be given to choosing an administrator ("executor") of your estate. The executor has to protect and administer your estate in a prudent and responsible manner. This person should be trustworthy, familiar with tax, estate, accounting and investment issues, and be willing and able to assume such a responsibility. Naming an alternate executor in case the first one is unable or unwilling to do the job is usually a good idea.

Also very important is the question of who will take care of your children should you and your spouse pass away. When deciding who to select, keep in mind the age of the guardian(s), their health and ability to care for your children. It is recommended that you speak to those being considered to confirm they are willing to accept such a responsibility, and naming a back up in case they can't or won't take on this responsibility is also a good idea.

Your Will has been prepared. Now what?

Once you have prepared your Will, you must remember to keep it updated. You should review your Will regularly and amend it whenever there is a significant event in your life or the lives of your heirs, such as a marriage, divorce, birth, death, disability, new business or other major life event. Keep in mind that in most provinces other than Quebec, marriage revokes an existing Will unless the Will specifically contemplates the marriage. A Will should also be reviewed after a change to income tax, family or successor laws.

Ideally, a Will should be reviewed every year or two even if there haven't been any significant changes to ensure that it continues to reflect your intentions.

What is a Holograph Will?

This is simply a handwritten Will that is signed only by you. A typed Will or a fill-in-the-blanks Will does not qualify as a Holograph Will. Holograph Wills can be problematic if the instructions are not absolutely clear. Furthermore, some provinces don't recognize Holograph Wills or have different signing requirements. One must be careful with this type of Will.

Protection for you and your family

A Will is the foundation of an estate plan. Having a properly drafted Will means that your assets will be distributed according to your wishes and that your loved ones will be properly provided for in a tax efficient manner. You can avoid unnecessary costs and delays, and the undesirable results that come with an intestacy, and have the ability to choose the executor of your estate and the guardians of your children. When one considers that most Wills can be prepared for a few hundred dollars, and the potential consequences of not having one, it is clear that everyone should have a Will.

Do common-law partners have the same rights as spouses?

Although common-law partners are treated the same as spouses for tax purposes, their rights under certain provincial estate laws are limited, and vary from province to province.

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How Is Your Will Power?

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Even when an individual has no assets or family, it is still important to draft an updated will, at least to indicate your funeral and burial wishes.

16 good reasons why you might want to update your will.

1. Your relationship to, or the health of your executor(s) or children's guardian(s) has changed negatively.

2. Your executor no longer lives near you.

3. You have inherited monies or have become beneficiary of a life insurance policy.

4. You recently married, or a recent marriage soured since you made out a reciprocal (joint) will.

5. Your pre-established children's guardians have become irresponsible.

6. A partner has bought or is buying your business previously bequeathed in your will.

7. You have purchased new assets such as an art collection, real estate or a cottage.

8. A spouse, parent, or child has become disabled and needs future care.

9. You desire to leave a legacy in the form of a family trust through the directives of the will.

10. You want to establish planned giving to leave monies, for example, to a charity, an art gallery, a church or a school.

11. You have changed your lawyer or accountant.

12. You want to change your trustee, or trust institution in charge of investments within a testamentary trust directive.

13. You want to change or revoke a previous beneficiary directive or add a new beneficiary.

14. You want to change how you deal with estate tax liabilities.

15. A joint will with your spouse with equivalent clauses is now too simple for your complex estate and must be changed to two distinct wills.

16. Federal or provincial budgets have changed legislation affecting your estate planning.

We suggest that your lawyer help you review your current will now and on a cyclic five year basis.

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Live For Today, Plan For Tomorrow

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Everyone of sound mind, having attained the age of majority, should have a Power of Attorney and a Living Will--two very important legal documents setting forth health care guidelines.

POWER OF ATTORNEY

A Power of Attorney (PA) is a powerful document giving authority to another person to make decisions and act on your behalf. If you were seriously hurt, mentally incapacitated or simply out of the country, a person authorized as your "attorney" could act in your stead. That person could, for example, renew your mortgage, pay your bills and manage your investments.

What happens if I don't have a Power of Attorney?

Without court intervention, your spouse or children could not legally look after your financial transactions if you were incapacitated. A government appointed trustee would manage your affairs. A family member would then need to apply to be appointed as acting attorney.

What is the extent of these powers?

PAs which are referred to as "general" give powers over all financial transactions. PAs that are called "limited" restrict authorization to specific transactions such as selling your home, banking, investing or handling pension cheques. Where major decisions will need to be made, consider writing out instructions for your attorney. Though these instructions are not legally binding, you may state, in advance, exactly how your assets or property should be handled.

Who can be a Power of Attorney?

Usually, your spouse or a trusted family member is chosen. Alternatively, others prefer a trust company or lawyer as their attorney.

Under what circumstances is the authority valid?

In order for a PA's authority to continue on beyond any mental incapacity, the documentation must state that the PA is to endure--otherwise the attorney's authority ceases to survive any state of mental incompetence. Not all the invested powers of the PA should be assigned without careful thought. Your attorney will have full access to do all your financial transactions, including banking, buying or selling real estate, loaning money and transferring investments.

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Terminating a Power of Attorney

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A Power of Attorney (PA) document gives authority to another person to make decisions and act on your behalf. Consider these reasons why you, the Donor, might want to revoke the PA and cancel the attorney's authority.

- a discovery that the PA behaves dishonestly or irresponsibly or has lost interest in your affairs.
- a previous arrangement wherein a family member who was to act as PA, is deceased or mentally incapacitated.
- a previous arrangement wherein a lawyer, who was retained to act as your PA, is now deceased, incapacitated, retired or you have changed lawyers.
- a previous arrangement wherein a joint or backup PA is now deceased or mentally incapacitated.
- a souring of your relationship with your PA.

The Revocation of Power of Attorney document revokes your previous Power of Attorney. The actual attorney set forth in the PA must be presented with a copy of the Revocation of Power of Attorney, informing that all previous authorization to act as the attorney has now ceased to be legally binding. If more than one attorney was authorized, each should receive a copy specifying the revocation date.

The Donor must sign the document. A witness other than the attorney or a relative of the attorney, must also sign the document and swear or affirm an Affidavit of Execution before a Commissioner for Oaths or Notary Public. If the Revocation of Power of Attorney will revoke a 'Power of Attorney for Personal Care' or a 'Continuing Power of Attorney for Property', the following persons cannot witness the document:

- the attorney or his or her spouse or partner.
- your spouse or partner.
- your children.
- a person whose property or person is under guardianship.
- a person under 18 years of age.

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HERE ARE SOME SAFEGUARDS

- Choose honest and responsible people who truly care about your future.
- Consider establishing a family member and your lawyer as joint attorneys.
- Set forth limitations within the text to reduce potential abuses of authority.
- State that the PA is invalid unless you are declared mentally incompetent.
- Have your lawyer hold the PA document and written instructions.
- State that a backup attorney can act just in case the initial attorney chosen is unable or unwilling.
- Revoke your attorney's rights if your relationship with him or her goes sour.

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Power & Powder Kegs

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In a nutshell, a Power of Attorney (POA) is a legal instrument that allows you to authorize a person to act in your stead as your attorney or agent. A POA would be needed, for example, if you were travelling in Europe for several months. It is very important to select a highly trusted individual to be your legal representative and to define the limits, if any, of his or her duties.

A General Power of Attorney will extend powers to all aspects of your affairs. A Specific Power of Attorney will deal with only special duties such as allowing another individual to do your banking or investing for you, or to buy or sell property on your behalf.

Potential Powder Kegs

- Any person over 18 years of age who tends to his or her own affairs without a guardian should have a Power of Attorney. Without one, bills and loan payments could go unpaid, and RRSPs and investments may not be properly reviewed.
- If a person becomes mentally incompetent, a General Power of Attorney will not suffice. In this case, the disabled person would require an Enduring Power of Attorney. If there are college or university children, their education could suffer if there is no directive to pay for tuition.
- When a person dies, their POA ceases to have authority. It is therefore important that there is a continuum of authority from the POA to the will.
- Visit your lawyer, have a POA prepared, and plan to review and update it. You can sign several different POAs over a lifetime, and they can be terminated or simply be authorized for only certain times. Without a POA, either the courts or the Public Trustee will make arrangements on your behalf.

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Do You Have Money in Your Genes?

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Over 3 million Canadians will pass an average of one quarter of a million dollars to their children over the next 30 years. Consider that 50% of all personal assets are owned by people 50 years or older. The inheriting children will be faced with a host of new responsibilities when they inherit. They will have to decide: should I sell the house, what assets should I keep or place in storage, which assets should I share, which should I sell? Most parents bequeath their estate hoping that their children will enjoy their assets and gain financial security. If you are an inheritor, here are some guidelines:

- Be leery of those in a hurry to transact business immediately after bereavement, especially when you are grieving.
- Get the advice of a competent lawyer, especially if the estate has some planning concerns that may affect you, such as succession planning in a business.
- After time for grieving, call a professional financial advisor and put together a balanced investment portfolio applicable to your age and life situation.
- Get the advice of a good real estate broker if you have property to sell. Time the sale preferably when the real estate markets are up.
- Hire an accountant with estate and tax planning expertise if your inheritance is complex or if there is an offshore property.
- Before selling, get all art and jewelry appraised of its value by professionals in these fields and place objects in an insured warehouse.
- Be careful of acting on the advice of friends before you seek professional counsel in all the above areas.
- If your parents have openly discussed that you are an heir, consider talking with them about the above points where applicable.

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The Living Will

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The Living Will is a document in which you state your wishes regarding the refusal of medical care. It comes into play only if you cannot make those decisions yourself. If you become incapacitated, with no possibility of recovery from mental or physical disability, would you prefer to live or die? This hard question, once answered, will determine the directives you set forth in your Living Will.

Most of the provinces are writing new laws recognizing Living Wills. Even if not yet legally binding, a Living Will allows you to indicate your wishes providing guidelines for your family physician, family members and friends--those who would be asked to make health care decisions on your behalf. Formulate your Living Will with a lawyer and these potential decision-makers. Give each of them a copy, updated annually, for reference. Have at least two of them witness each copy.

The Living Will alleviates the heavy burden of deciding to allow a loved one to die. By setting forth your request in advance with a clear mind, you intentionally share in that great responsibility, thus lessening any feelings of fear, guilt or indecision that these people may have to face.

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Where There's a Will, There's a Way

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Making a will is an essential first step in estate planning. Young people, struggling to make ends meet, may think their assets too meager to worry about who will inherit them. But for anyone starting a family, a will is as important as buying diapers.

Lawyers usually see two groups of will writers: the elderly thinking about leaving assets to their heirs; and young couples concerned about how their children will be raised should they pass away prematurely.

For parents, the key factor is to ensure that they choose a guardian who will care lovingly for their offspring until maturity. By naming a guardian themselves, usually a relative or close friend with compatible moral values, parents avoid unpleasant (and asset-consuming) squabbles. If you die intestate (without a will), a stranger (very likely a judge), could adjudicate competing family claims and award custody of your little ones to someone you might find irresponsible.

In the absence of a will, your assets will be divided according to a prescribed formula: generally favouring a legal spouse (but often excluding common law relationships), blood relatives and those legally adopted. If you have no spouse or children, your closest surviving relative will inherit. The succession among your survivors is usually: parents, brothers and sisters, nephews and nieces, followed by any other kin, however distant. If you have no surviving relatives, the taxman gets the lot. Your friends are out of the picture. A single twenty-something may have preferred to bequeath his/her red Mustang and CD collection to a school buddy rather than to well-heeled parents or affluent elder siblings.

Eliminate procrastination—be sure you consult a lawyer who can write a will specific to the jurisdiction where you live. While generally similar, wills and estate legislation vary by province. Many people feel comfortable using do-it-yourself kits for simple wills. Fees begin at about $200 for a couple with uncomplicated wishes.

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Little or Big, Estate Planning is Necessary

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When you hear the phrase "estate planning", you might only associate it with the rich and the famous. However, if you have a significant mutual fund portfolio, either registered as an RRSP/ RRIF, or non-registered, your estate could face significant taxation. For example, an RRSP of $200,000 will be taxed at approximately 50%, leaving your heirs $100,000. Any capital gains on equity mutual funds will be taxed at 75% of your marginal income tax bracket. A capital gain of $50,000 in a 50% tax bracket will incur a tax bill of approximately $18,750.

Reduce taxes, while planning to transfer assets to the next generation. If you own a business, there may be future tax liabilities involved in leaving these assets to heirs or selling them to a partner. Where children will be taking over a family business, taxes on any future growth can be deferred through an estate planning tactic referred to as an estate freeze.

If you have children and/or a spouse, estate planning could be essential to saving thousands of dollars in taxes. The whole purpose of estate planning is to move your assets over to the next generation in the most tax efficient manner. Though your net worth may be small now, if you have a growing business, or if you invest heavily in mutual funds, your business and your investment portfolio will attract tax on any capital gain upon your death (or after your spouse's death).

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Side-Stepping Probate

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Estate is the legal term for your financial affairs after you die. When an individual dies, his or her last will and testament is read. Because financial matters need tending to, your will should outline how you want your assets divided, your debts paid, and if applicable, should define the management of these assets using established trusts for your heirs. Family members may read a will if it is in their possession. Next, the will must go to the executor who then assesses if it needs to be probated--if court approval must be obtained to settle your estate and transfer the ownership of your assets. Probate is generally necessary in cases when:

- a bank, trust company or other financial institution insists on the will being probated to prove that the executor has the authority to act.
- the assets include shares owned in a private company.
- the executor needs to sue an individual owing the estate money.
- there are creditors due money from the estate.
- a will's terminology is unclear, ambiguous or certain provisions are not stated. (For example, if there is no provision to pass assets to another heir where a spouse has predeceased you).
- a will is improperly witnessed.

Note: In Quebec, probate is not needed when a notary under seal prepared the will.

It is a big job for the executor to probate a will. The original will must be submitted with an inventory listing the estate's assets recorded at their fair market value to the court in the jurisdiction where the deceased last lived. There may be increased fees if a lawyer is retained to cross-examine the asset list or if the executor charges a percentage of the asset base to do the work.

Probate fees are paid from an estate to the provincial court. These fees are approximately .5% to 1.5% of the estate's assets, depending on the size of the estate and the province. Provincial lawyers complete the necessary 'letters of probate' or 'grant of probate document.' In Ontario they are referred to now as 'the certificate of appointment of estate trustee with a will.'

Because probate is calculated on assets, regardless of liabilities, an estate with assets of one million dollars and liabilities of $200,000 would pay probate on the entire million. In addition, if these same assets are transferred to your spouse, probate fees may be due again the second time around when these assets are transferred through his or her will. These fees are paid with after-tax dollars, as they are not deductible on the final income tax return. There is no law stating that a simple will and estate needs probating.

Here are Some Methods to Minimize the Need for Probate:

- Hold assets jointly. Probate fees will be charged when that asset is transferred later

through the will of the second spouse.

- Establish a person as a beneficiary on your life insurance policies independent of the estate. This way, all monies pass to the heirs tax-free. If the estate needs probating, this portion of the assets will not be included in the estate, as the death benefit will flow directly to the heirs circumventing scrutiny.
- Name your beneficiaries on your RRSPs and RRIFs. Insurance companies will allow you to side-step probate in this way. To protect themselves, banks and trust companies will probably require probate or a letter of indemnity from the estate's lawyer if these assets are over $30,000. If your spouse is your beneficiary, consider a secondary beneficiary, should your spouse die at the same time you do.
- Consider setting up a spousal testamentary trust in your will to avoid double probate. When the second spouse dies, the assets can be distributed via the trust directives as opposed to a will.
- With your spouse, set up mutually owned property as 'joint tenants with rights of survivorship' to transfer these assets automatically outside of the will.

Once a will has been probated and the executor confirmed, he or she could start transferring assets as directed by the will. Some assets can be transferred easily within a short period of time. Others have to wait until the estate expenses have been paid, including any final income taxes due to Revenue Canada, after which they will issue a tax clearance certificate.

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Pre-Funding Funeral Expenses

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When planning a funeral last minute, it may be difficult to think clearly. Therefore, pre-planning makes sense. Expenses can range from $1,500 to $5,000 or higher, depending on the funeral home and the services purchased such as:

- cremation or burial
- transfer of the body from a hospital, nursing home or another country
- embalming
- casket
- service in a funeral home or church

Pre-paying Funeral Expenses A funeral can be pre-paid and the funds held in trust (free of income tax up to a certain limit). Advise your executor of your plans and/or pre-payment to a funeral home in order to save both unnecessary funeral arrangements and expenses.

By taking care of your funeral in advance you:

- allow time for comparison and cost evaluation
- guard your survivors from the stress of making decisions while grieving

Pre-funding Funeral Expenses One of the best methods to pay for a funeral is to pre-fund as opposed to pre-pay. You can pre-fund the entire cost with a life insurance policy that pays out a tax-free benefit (usually within 30 days), without probate, at death. Establish the price with the funeral home in a contract, as you will be deferring payment until the time of death.

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Settling Your Estate and the Tax Consequences

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Whenever we begin serious estate planning, we cannot help thinking that we may be moving a little too fast, getting a little too close to our mortality. However, the need for estate planning is especially evident for those accumulating any kind of wealth, either in the form of business ownership, real property or investment assets. You've all heard the cliché "You can't take it with you." Well, the reason you can't take it with you is that taxes can reduce one's estate. Taxes are payable on income accrued to the date of death including salary, investment income or dividends.

So far as the Income Tax Act goes, you are deemed to have disposed of all your capital assets, including stocks, bonds and mutual funds, at their fair market value just prior to your death. In the year of your death, gains accrued on your investments and other capital property will become taxable, reduced by accrued losses on investments and other capital properties. You will need professional tax advice when developing your estate plan.

Leaving Non-Registered Assets to Your Spouse

A surviving spouse can continue to benefit from your assets. You can defer tax payable on your accrued gains at death if you leave your assets to your surviving spouse or to a spousal trust established for the sole benefit of your spouse during his or her lifetime. The taxes are deferred until the death of your spouse or until he or she sells the assets. The deferral allows your spouse to utilize your investment assets in a tax efficient manner and to dispose of assets in a way to minimize the taxation.

Leaving RRSPs and RRIFs to Your Spouse

Did you realize that your RRSPs and RRIFs would be subject to immediate tax on your death unless you have established your spouse or a financially dependent child as your beneficiary, and certain other conditions are met? Tax will be payable when monies are withdrawn as income by your spouse or as annuity payments to financially dependent children. Even if you have not established your spouse as your beneficiary, he or she may be able to legally request a transfer of your RRSP/RRIF funds to his or her RRSP/RRIF and defer the tax that would otherwise be payable upon your death. However, upon your spouse's death, any remaining RRSP/RRIF money will be taxed (assuming there are no financially dependent children). Any RRSP/RRIF tax liability could optionally be paid using a special pre-designed life insurance strategy to help maintain your asset base and is transferable to heirs surviving your spouse.

The success of an estate plan is not defined by tax planning alone. Effective estate planning facilitates the transfer of your assets to your beneficiaries, providing an adequate income or enhanced lifestyle for them, while minimizing taxation.

A Tip for Business Owners

Ask your tax specialist if your capital gains can be offset by any unused portion of your $500,000 capital gains exemption available on certain small business shares and farm property.

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Estate Taxes on U.S. Property

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If you are a Canadian resident and own property in the U.S., estate planning is important to reduce taxes because you will eventually be taxed by both tax systems on any capital gains that arise on the sale of the real estate. It will be deemed to have been disposed of at fair market value upon your death if the property is left to someone other than your spouse. The gain must be brought into income on your final Canadian tax return in the year of your death.

In addition, Canadians are levied an estate tax by the U.S. on certain U.S. assets and real estate personally owned at the time of death, based on the entire fair market value of U.S.-held assets, not just on the capital gain. For this reason, it may be a bad deal for a Canadian who purchases an expensive property, then dies shortly after the purchase. It is especially onerous if there is an uninsured mortgage on the property. If your ideal is to leave the property to your children, you must ask yourself, "Will the tax bill force them to sell the property?"

Canada-U.S. Income Tax Treaty

Canada and the U.S. have agreed to reduce the burden of double taxation for their residents owning property in the other's nation. Subject to limitations, part or all of the taxes paid on the property to the U.S. tax system at the time of death or at the time of sale will be credited to reduce your Canadian tax payable on the capital gain.

Note: It is recommended that you seek the advice of a professional who is experienced in tax issues in relation to the Canada-U.S. Income Tax Treaty.

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Estate Taxation on an Equity Mutual Fund Portfolio

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Compare Leaving Assets to Your Spouse and Non-Spousal Heirs

Let's look at an example of a current non-registered equity mutual fund portfolio. If valued at $225,000 today, with an adjusted cost base of $50,000, what will the tax implications be? If, as of February 22, 1994, you had used up all of your capital gains exemption, you would face taxation if the assets are left to a non-spousal heir. The taxes would be deferred if the assets were left to the spouse.

	If left to Heirs	
	Your Spouse	Your Sister
Value of deemed disposition	$50,000	$225,000
Adjusted cost base	$50,000	$50,000
Resulting capital gain on death	Nil	$175,000
Taxable capital gain (75%) (on final return)	Nil	$131,250
Taxes due on final return (assuming 50% tax rate)	Nil	$65,625

Tax of about $65,625 would be due from the gains on these investments, not including surtaxes, when left to your sister. When left to your spouse, tax on the capital gain is deferred until your spouse sells them or dies.

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If I Give Money to My Children While I'm Living, Can I Reduce My Estate Taxes?

Written and published by Canadian Financial Publishing Group Inc.

Passing assets to your beneficiaries while alive is referred to as gifting. Gifting will allow you to circumvent probate fees and executor fees associated with the administration of your estate. As well, you can actually see the beneficiaries utilize and enjoy your assets. If you gift money to a charity, you will get a tax break via charitable receipts. And when you gift in advance there is less chance of family quibbling over your will.

If you want to give cash to an adult child for the purpose of making an RRSP contribution, the child may get years of tax-free growth on the invested money, whereas you would pay tax on it if invested in your own non-registered portfolio. After the gift is made, you will no longer pay tax on the income generated by that sum.

The downside of gifting is that you could trigger a sizable capital gain (where the value of the asset has increased over what you paid for it) on the disposition of your asset to your beneficiary. Then you must recognize any resulting capital gain or loss on that year's income tax return. Other than your spouse being the recipient beneficiary, any asset that you gift during your lifetime, will be deemed to have been disposed of at the asset's FMV (fair market value). You will lose control of an asset when you give it to someone else. If the asset is a cottage or a home, this may not be a good idea.

The tax liability on income may also be attributed back to you when you give an asset to a spouse or minor child, until that child reaches age 18. If the beneficiary is a child aged 18 or over, the related future tax on income and capital gains will be due in his or her hands. By gifting to a minor child, future capital gains will be considered his or her own, but interest or dividend income will be attributed back to the parents.

You must be mentally competent to gift your property, and there cannot be any strings attached. Once the cheque is cashed, the ownership or deeds legally changed, or the item is delivered, the gift is considered completed. Therefore, be careful not to gift too soon if gifting will create a tax liability that will reduce your assets considerably, or by the gifting of the asset your retirement income is reduced to the extent it will make you dependent.

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Passing Your Cottage To Your Kids

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If you own a cottage, there may be family quarrels over who will pay for its upkeep and/or use it once you die. Here are some alternatives:

- plan to have the cottage held in a testamentary trust after you die
- maintain control-set up a living trust so the cottage won't form part of your estate at death
- if they want it, give or sell the cottage to the children while you are alive

Deemed disposition

Whether ownership of a cottage goes directly to beneficiaries or into a trust, a deemed disposition takes place. This means that if the value has increased, capital gains tax might have to be paid.

Your accountant can help you calculate what that might be, based on the current fair market value of the property over what you paid for it. Bear in mind that, generally, the net growth in value will be taxed at 75% when disposed of or upon your death. Large capital gains can put you in a much higher tax bracket the year the disposition occurs.

If you leave the cottage to one child in the will

Where there is one child, who, to the exclusion of others, will receive your cottage, an inequity may occur. Your estate will pay the applicable capital gains tax on your cottage, thus lowering the remaining assets in your estate for equal distribution among the other children. Therefore, you may want to plan for estate equalization to the other heirs using life insurance proceeds. You could also increase the insurance to pay for the taxation on the cottage. If you are married, the asset is taxable in the estate of the last spouse to die (assuming the cottage passes to the surviving spouse, or spousal trust, on the death of the first spouse). A joint last-to-die life insurance policy may be a less costly method to look after this tax.

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Joint Life Insurance & Estate Planning

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Life insurance may be issued to insure more than one life, referred to as a joint policy. The death benefit is payable on either the first or the second death.

A joint last-to-die policy insures two lives, usually two spouses for the purpose of paying for an estate's tax liabilities on capital gains. As well, where one has significant family wealth in RRSPs or RRIFs, taxes will be due when the entire remaining RRSP or RRIF funds are brought into income. These taxes will be due after the death of the second spouse where there are no dependent children. A $200,000 RRSP or RRIF would be reduced to about half the sum after the death of the second spouse. By insuring the second-to-die for $100,000, that approximate difference lost to tax could be recuperated for the heirs. This can usually be mathematically justified, as the premium for the policy is usually small compared to the much larger tax bite. The death benefit itself is tax-free and guaranteed when you make your very first premium payment--as low as one monthly payment.

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Roles & Duties Of The Executor

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A trust company, friend, or family member, acting as your executor has the following responsibilities relating to your mutual fund investment portfolio:

- The distribution of mutual fund assets according to your will
- Locating the beneficiaries of your mutual fund investments
- Where applicable, make transfers 'in kind' to beneficiaries
- Providing some money from your mutual fund investments for surviving family members (there may be a short delay if the estate is probated)
- Evaluating mutual fund investments and collecting income payments
- Selling mutual fund assets, where necessary, to pay taxes, debts, legacies and bequests, and closing accounts where applicable. When deciding to sell a particular mutual fund investment, the executor must weigh economic conditions and tax consequences
- Handling and answering correspondence with mutual fund companies
- Purchasing mutual fund units to make an RRSP contribution to a spousal RRSP Filing final tax returns. Paying any income tax due, including income reported from mutual fund capital gains, dividends, and interest earned. Getting a clearance certificate from Revenue Canada
- Consulting professionals such as trustees, accountants, lawyers, or financial advisors regarding the settling of large mutual fund portfolios, and paying them for their services
- If a portfolio exceeds a certain limit, letters probate may be required by a financial institution to allow release or sale of a mutual fund. (This normally will exclude mutual funds registered in an RRSP or RRIF where the surviving spouse is designated as the beneficiary)

Note: Utilize the services of a professional as an executor, such as an accountant or lawyer where there are many diverse types of investments in your estate. Don't name an executor without his or her consent. It is not clear in most provinces that an executor may purchase mutual funds unless expressly stated in the will.

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What To Do When A Family Member Dies

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When a family member dies, take these actions immediately.

1. Ascertain who will make the decisions. Where there is a will, the responsibility goes to the named executor who normally consults with the family. If declined, responsibility passes to the alternate executor (where one is appointed) . If there is no will, a mentally competent surviving spouse (or a relative, or friend), may make funeral arrangements, unless he or she is unwilling to take the legal or financial responsibility.

2. Check safety deposit boxes. Call his or her lawyer to access the will and/or any other document stating wishes regarding the funeral, service, or cemetery.

3. Notify any burial or memorial society to which the deceased belonged.

4. Where no funeral arrangements have been made, choose and call a funeral home and make funeral arrangements.

5. Contact a religious leader and/or wise friend for spiritual support.

6. Buy a cemetery plot if not pre-purchased.

7. Post an obituary in the appropriate newspaper(s).

8. Ask for and make copies of the death certificate.

9. Find out if any commitment was made regarding the use of organs, tissue, or the entire body for medical or research purposes.

10. Call your doctor if you or any other family member experiences nervousness, insomnia, hysteria, anxiety or angina pain.

Note: Executors (or a court appointed administrator) are the only persons entitled to make funeral and burial decisions but they should consult the family for their wishes. If the deceased left instructions in the will or pre-planned the funeral, the executor should, but is not legally bound to follow the deceased's wishes. The executor should be involved in the decisions immediately after death. Check with your lawyer regarding laws that may affect you in your province.