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Client Information Summary

Estate planning - Creating and Preserving an Estate

The estate of an individual can be described as all of their assets they own less all of their liabilities. Anyone with assets needs an estate plan. Estate planning is the skilled practice of designing a plan for the effective enjoyment, ownership, management, and disposition of assets during life, upon death, and after death, while minimizing taxes and fees.

The estate planning process requires technically competent advisors who possess considerable skill and knowledge. The advisors must be cognizant of the personality of the individual, their goals and objectives, their priorities and preferences, and their interpersonal relationships. Since decisions affecting estate plans are very personal, sensitivity is a prerequisite in supplying advice or applying technical knowledge to individual circumstances in order to create an estate plan that will achieve the goals and concerns of all parties.

Regardless of a person's age, the estate planning process cannot be ignored. It is an essential and important part of personal financial management. Many believe that estate planning is only for those who are of advanced age or approaching death. This is a misconception. Since the waste of a single asset to taxes could prevent the accomplishment of the desired objectives and bring hardship to the family unit, estate planning may be even more important to the owner of a medium-sized estate than to the owner of a large estate.

The fundamental objective of estate planning is to nurture wealth building in one's own individual estate while minimizing the overall tax burden for all members of the family unit. Thus, estate planning is **all** of the following: the creation of wealth, the preservation of wealth, and the conservation of the estate at death, or even beyond death by way of trusts.

COMMON GOALS OF ESTATE PLANNING

The goals of estate planning are many, and varied. Some of the common ones are to:

- maintain family harmony
- minimize taxes
- preserve the estate or avert a liquidity crisis (i.e. having accessible cash for contingencies or to pay taxes)
- retention of assets within the family (i.e. such as cottages and businesses)
- provide for capital needs or bequests to certain family members (by way of gifts and trusts)
- provide for the financial security of survivors and loved ones

The following is a brief overview of these common goals:

To Maintain Family Harmony

Nearly everyone knows of a case of disruptive family relations precipitated by changing events at the death of a family member. Such circumstances are typically due to the lack of an estate plan.

Similar conflicts may also occur while alive when certain assets are gifted or sold to family members to the exclusion of others, based on needs or ability (e.g. assistance on down payment for first house, involvement in family business).

In order not to cause conflict among family members, compassion must be exercised in a discreet manner. A well intentioned but poorly drafted and executed plan can create emotional scars. A classic example is the bequest of the family cottage to the child who will enjoy that lifestyle the most, while leaving a second child the investment portfolio of similar value at time of drafting one's will, only to have very disparate values later at time of death. Good planning does not leave intentions and fairness to chance.

To Minimize Taxes

This is a very common goal. Income splitting between spouses, children or members of the extended family (grandchildren, nieces, nephews, etc.) is appropriate for certain situations.

Estate freezes can be used to transfer future growth in certain assets to the next generation. This is done in order to maximize estate values by deferring taxes or utilizing any available capital gains of other family members.

In order to conserve an estate at death and defer some tax liabilities, certain roll over provisions are used. For example RRSP's and capital assets roll to surviving spouse, and non-qualified assets can be bequeathed to other beneficiaries.

To Preserve the Estate or Avert Liquidity Crisis

In some cases, a portion of the wealth of an estate can be wiped out while the person was still alive by failure to plan prudently or allow for contingencies and emergencies. In other cases, the taxes triggered by a deemed disposition of certain assets upon death can create a liquidity crisis, which in turn can result in certain invested assets being sold at an inopportune time or at depressed values to create needed cash.

Every estate plan needs a Power of Attorney to designate a trusted person, such as a spouse, friend, or a professional to act as agent should the individual become incapacitated.

To Retain Assets Within the Family

In many cases, the family cottage or family business may have to be sold either prior to death or after death. The asset may be sold in order to provide needed cash to pay taxes (e.g. capital gains), cover final expenses, or other bequests, leaving the intentions and wishes unfulfilled.

Trusts and Gifts to Provide For Capital Needs, Gifts or Bequests to Certain Family Members

Lump sums in the form of an inter-vivos gift (i.e. while still alive) to an intended beneficiary may be appropriate in certain circumstances since there is no gift tax in Canada. Such inter-vivos gifts will also be conclusive and beyond any future challenge as to the intentions of the testator's will.

Certain future needs of beneficiaries can be provided for in advance by creating an inter-vivos trust with specific terms as to payments and disbursement of the funds. Alternatively, these needs can be provided at death with testamentary trusts to provide future funding. Testamentary trusts are also a very effective way of splitting income. For example, if one or more of the beneficiaries are already in a high tax bracket, a testamentary trust can create one or more additional tax payers, each subject to the graduated tax rates (but not individual exemptions). This can create savings of $8,000 or more per year. Another possibility is to designate a portion of a large estate to by-pass one generation to go to the next generation as a “generation-skipping” trust.

To Provide For the Financial Security of Survivors and Loved Ones

This could include: the use of life insurance to create immediate capital at death and to offset the lost income of a testator; the use of trusts to conserve existing capital until designated disposition dates; the use of trusts or life interests to provide continual funds for certain beneficiaries while alive, with the assets remaining to pass to another beneficiary.

It should be noted that the presence of a marriage or co-habitation agreement directly effects the distribution of assets in the will.

Other possible goals and concerns to address under estate planning might include:

<u>Judgment-Proofing</u>

This is a concern where the individuals are professionals or business owners want to ensure that their estate consists of judgment-proof and creditor-proof assets in order to protect them against malpractice lawsuits, litigations and creditors.

<u>By-Pass Probate</u>

In recent years, probate fees, a form of administrative tax on a testamentary estate levied by the provincial government, have increased. Probate fees are calculated based on the **gross** value of the assets, not the net value of an estate. Probate fees can be reduced by planning around the use of joint ownership for certain assets.

With joint ownership, the asset does not form part of the testamentary estate since the ownership passes to the surviving joint owner at the time of death. Use of joint ownership with right of survivorship should be used with care to avoid the possibility of creditors of the joint owner or having the joint asset included in the family property of the joint owner (this can be a problem when the joint owner is an adult child). The use of named beneficiaries for certain assets, such as life insurance proceeds, pension plans, etc., will generally avoid probate.

Assets subject to transfer at death pursuant to a legal agreement, such as a domestic (marriage or cohabitation) agreement, will also avoid probate. Gifting of assets or transfers to trusts prior to death will avoid probate, but care must be taken to account for attribution rules on taxable income of the gifted or transferred assets.

<u>Business Owners</u>

One objective of estate planning relating for business owners is to assist them in making prudent decisions in matters related to the business that will impact on the owners, their family, their successors and managers. With most successful business owners, the business represents a significant asset in the estate; therefore, the orderly succession is critical to developing an effective estate plan in order to preserve the value of the business as an operating business concern.

These issues include the question of control, putting in place an estate freeze, and liquidity concerns, and of course providing for the survivors, retirement, and permitting family and/or outsiders to participate in the business. The mere existence of a business adds to the complexity of an estate. Therefore, planning should not be restricted to family members but should include financial, legal and accounting advisors, as well as managers, executors and trustees.

Without an estate Plan, the surviving family members of the business owner may be faced with a financial crisis in the event of the disability or death of the business owner due to their lack of knowledge of the affairs of the business. For a business with multiple owners, an estate plan must include a well drafted shareholders' agreement with specific buy-sell provisions. Often these provisions will require life insurance to provide the necessary capital to fund the provisions.

Multiple Wills and estate Plans for a Multi-Jurisdictional estate

A large estate with sizeable assets in several jurisdictions may be more expeditiously administered via an inter-vivos trust or at death with separate wills stipulating the disposition of the different assets situated in each of the countries or provinces.

Multiple wills can be probated without holdups in each of the multiple jurisdictions. In future, a single international will may be appropriate in recognizing jurisdictions, pursuant to the "International Will Convention" of The Hague, 1978. Canada has signed the convention but the provinces (Ontario) have yet to ratify.

U.S. Estate Tax

Under U.S. legislation Canadians who are non-resident in the U.S. but have assets situated in the United States, are liable for estate taxes in the event of a death when the exemption amount is exceeded.

Assets includes real property, unincorporated business interests, shares of U.S. corporations, mutual funds based in, and operated from, the United States, and debt obligations of U.S. corporations. Included as debt obligations are pension obligations of U.S. corporations (but not those of Canadian subsidiaries). Assets also include partnerships or trusts and tangible personal properties located in the United States (clothing, jewelry, automobiles, boats, furniture, works of art, currency and club memberships).

These properties may also face Canadian capital gains tax as well, without receiving any credit for the U.S. estate tax paid, resulting in a combined tax liability of up to 91% of the U.S. portion of a large estate. Excluded are life insurance proceeds and most bank deposits (if not connected with a U.S. trade or business).

THE PROCESS

Awareness of estate planning will create the impetus to pull together all the components in the financial and personal affairs of the individual and the family into a viable and workable plan, with help from competent advisors.

Estate Plans range from a simple will to a complex set of trusts and the use of holding companies. Other progressive planning strategies involve crystallization of capital gains, estate freezes, transfers or gifts of properties, use of direct beneficiaries outside of the testamentary estate, joint title or life interest in properties, offshore trusts and spousal trusts, just to name a few.

Effective estate planning requires the advice of specialists from all fields (taxation, estate law, family law, and insurance). Since each case is different, a complete understanding of the relevant facts as well as the needs and intentions of the individual and the family are essential as preliminary steps in developing an estate plan. None of these factors can be dealt with in isolation.

This task is less onerous when completed as part of a complete comprehensive financial plan prepared by a strategic advisor. Without this comprehensive framework, along with ongoing evaluation, an individual may end up with conflicting recommendations from various advisors.

Once an estate plan is completed, it should be reviewed periodically to ensure that changing circumstances in the extended family unit, such as divorce or re-marriage, have not resulted in unintended beneficiaries. A review is also recommended after any significant tax law changes. This information summary is intended to increase the awareness of the importance estate planning for the reader. Readers should consult their own personal advisor for individual recommendations and other estate planning issues not covered in this summary.

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