Planning for succession

Working a lifetime to accumulate the wealth of your estate, calls for one more wise decision: how to leave the most to your loved ones and the least to the taxman.

Estate-succession planning does not have to be difficult...

Unfortunately death and taxes are not mutually exclusive. Whether you are a business owner or just own appreciable assets such as securities or real estate, planning is essential to allow for a smooth transition in a tax-efficient manner.

Need to know...

In most situations, there is a fair market value deemed disposition of capital property held by the decedent at the time of death unless the property passes to one's spouse. Similar rules are in effect for RRSPs and Registered Retirement Income Funds ("RRIF").

Will planning

Will provisions should be consistent with current tax and family law legislation as well as with your shareholders' agreement.

Probate is the process in which the Court confirms your Will for a 1.5% fee on the assigned value of your assets. Most financial institutions will require probate. For many years, we have been utilizing dual Wills in Ontario. The secondary Will is prepared for assets not requiring probate such as shares of your private corporation and personal property which may constitute a significant portion of your estate. Hence, significant probate savings are readily available by utilizing a secondary Will.

Alternative methods of ownership

There is no probate on assets that go directly to individuals. Assets held jointly or jointly with right of survivorship ("JWRS") or RRSPs, RRIFs and insurance products with specific beneficiary designations will not have probate. If your "Estate" is the designated beneficiary, probate will apply. JWRS may result in unintended disputes if one party challenges legal ownership. JWRS assets may be exposed to marital or creditor claims or loss of the principal residence exemption for a joint owner.

Converting ownership will result in a fair market value disposition if there is a change in beneficial and legal ownership. This could result in unintended capital gains. A properly prepared trustee document may confirm no change in beneficial ownership.

Alter ego/ joint partner trusts

If you are 65 years of age, you as settlor of the trust may transfer assets to an alter ego or joint partner trust. Here, assets are not subject to probate and generally, may not be subject to creditor claims. Not only is public disclosure of the assets on death avoided, the use of the trust will protect the assets from potential challenges that could otherwise occur with Will planning. Beneficiaries are appointed in the trust indenture.

There is no tax on any unrealized gain on transferring assets to the trust, however there is a deemed disposition at fair market on the death of the settlor with an alter ego trust. With a joint partner trust, the disposition is on the death of the surviving spouse. On death, tax is levied at the top rate on unrealized capital gains, with no capital gains exemption available.

Income earned by the trust during your lifetime is taxed in the trust at the top rate unless the income is paid to you, taxed at your marginal tax rate. These trusts are generally used for fixed income assets.

Testamentary trusts

Testamentary trusts, whether spousal or non-spousal, are an easy, flexible and effective way to minimize tax on future income derived by assets of your estate and to facilitate a sale or transfer of your shares in a tax-effective manner.

A testamentary trust acts as a separate person, utilizing graduated tax rates. For example, if your spouse has no other income, $100,000 of interest income from estate assets will attract tax of approximately $28,150. If this income was split equally with the trust, the combined tax would be approximately $20,100, for a savings of $8,050 annually. Splitting of income may avoid a reduction or clawback in your spouse's old age security.

Without a provision in your Will to create the testamentary trust, your estate cannot reap the potential benefits. If it is determined at a later date that the trust may not be as beneficial, it may be wound up with the assets distributed to capital beneficiaries.

You may avoid probate and take advantage of testamentary trust planning with RRSPs/RRIFs/insurance products if you properly designate the beneficiary as 'a testamentary trust" created in your Will. Your financial advisor may have to discuss this procedure with the financial institution to ensure they will accommodate you.

Additional planning considerations

Capital losses from the sale of securities may be applied to capital gains reported in the terminal return if these assets are not distributed by the estate to capital beneficiaries before the end of the first taxation year of the estate.

Unpaid bonuses, dividends or social security benefits (CPP/OAS) payable at the time of death, may be reported on a separate rights or things tax return. The advantage of this special return, is that this type of income is not intermingled with other income reported on the terminal return, and is taxed at graduated rates with full refundable tax credits. Rights or things returns may be filed by the later of 1 year of the date of death or 90 days after receiving the notice of (re)assessment for the terminal return.

There are other post-mortem procedures that may facilitate a better tax result on the transition or wind-up of your operating or investment corporation provided your executors have the power to implement such procedures.

For example, procedures to extract surplus from a private corporation on a tax-free basis or the ability to increase in the underlying tax cost of corporate-held capital property, such as land or portfolio investments up to their fair market value at the time of death are also available.

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Compliance issues

The filing due date for the terminal tax return is April 30th for deaths occurring between January 1 and October 31st. For deaths occurring in November and December, the due date is 6 months subsequent to the date of death. The balance due date for a balance owing is the same as the due date of the return.

If the deceased operated an unincorporated business, the due date for the return is extended to June 15th from the foregoing April 30th date.

In order to meet these filing deadlines, executors should meet with the family accountant to discuss planning and information gathering procedures well in advance.

Winding-up the estate

When planning to wind-up the estate, the timing and dollar amount of the distribution of estate assets must be considered. Generally, after taxes are paid with the return filings, if possible, retained assets should not be income-producing to avoid another tax return filing.

Your executor must apply to CRA for a clearance certificate on CRA Form TX19 after receiving the notice of assessments for the terminal, rights/things and estate tax returns. Without clearance, executors will continue to be liable for unpaid taxes of the deceased, especially in situations where a reassessment is issued at a later date.

Summary

Updating your Wills and other critical legal agreements every 5-7 years to conform to changing tax and other legislation will pave the way for an orderly transition which we all want to achieve.■

Larry Stolberg CA,CPA,CFP

Disclaimer to readers: Contact your professional advisor prior to implementing any of the outlined strategies.

- Practice restricted to Canadian & U.S. taxation
- Unaudited financial statements available
- By appointment only

647-298-1339

lstolberg@lnsca.com

Larry Stolberg CA,CPA, CFP
TAX SPECIALIST
245 Commercial St. Milton, On L9T 2J3

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