

Hull on Estate and Succession Planning Podcast #10

A Discussion of Taxes

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Suzana Popovic-Montag: Hi, and welcome to Hull on Estate and Succession Planning. You are listening to episode #10 of our podcast on Tuesday, May 30th, 2006.

Welcome to Hull on Estate and Succession Planning, a series of podcasts hosted by Ian Hull and Suzana Popovic-Montag, that will provide information and insights into estate planning in Canada. From the offices of Hull Estate Mediation in Toronto, Ontario, Canada, here are Ian and Suzana.

Suzana Popovic-Montag: During our last podcast, we looked at the executor's income tax and accounting obligations and specifically discussed the informal accounts that an executor can keep and the formal accounts that he or she may have to prepare as well. We also talked about the investment of estate assets. We then turned to an examination of the interesting issues that arise when you have a recreational property in an estate, and we also looked at some creative ways to plan for capital gains taxes that arise on death. For the purposes of today's podcast, what I thought I would do, since I'm actually going to be flying solo, Ian won't be able to join us today, I thought I would talk about the taxes that arise on death. Many estate plans focus on reducing the taxes that are payable on your death, and there really is good reason to do so. While we don't have any specific death or inheritance taxes in Canada, the other taxes that arise on your death can still be quite substantial. Fortunately, with careful estate planning, you can reduce the taxes your estate will have to pay and increase the amounts your beneficiaries will ultimately receive.

There are basically three types of tax that can be payable on your death. Firstly, there is capital gains tax. You are actually deemed to sell all of your capital property when you die and your estate may pay the taxes on any capital gains subject to a \$500,000 lifetime exemption for capital gains from qualified small business shares and qualified farm property. Secondly, there are taxes on RRSPs and RRIF assets. Your tax sheltered assets, which are held in registered plans, such as Registered Retirement Savings Plans, which are referred to commonly as RRSPs, and Registered Retirement Income Funds, commonly referred to as RRIFs, they lose their tax shelter status at death and then their full value has to be included in your final tax return. And thirdly, we have probate fees. Here in Canada, courts in all of the provinces except for Alberta and Quebec, charge probate fees to confirm the validity of your Will. These fees are normally a percentage of the total value of the assets that pass under the Will. In Ontario, for example, the cost to your estate will be about 1.25% of the total asset value.

Not surprisingly then, we look at different ways to differ or reduce taxes on each of these three different headings separately. If we start with capital gains taxes, we know that you can defer capital gains taxes by transferring capital property to your spouse on your death. The taxes are then deferred until your spouse disposes of the property or dies. If

you have capital property that you think will substantially increase in value, you may want to consider transferring ownership of those types of assets to your children now rather than later. What this does is it allows you to defer the capital gains tax that arises on the asset after the date you transfer it until your child disposes of the asset which can be many years away. However, you do have to pay taxes on any capital gains that arise to the date of the transfer, you just want to keep that in mind.

There is also what is known as a principal residence exemption. And what that does is it provides that your principal residence is exempt from any capital gains taxes owing on your death. You can, of course, only have one principal residence, so if you own more than one residence, for example, you own a house and a cottage property, you should normally designate the residence with the greater amount of capital gains as your principal residence. And if you own your principal residence jointly with another person, it will be rolled over to that person on your death without any tax consequences.

If we look at the second heading that I outlined at the beginning, and we talk about the tax on RRSPs and RRIF assets, on your death, you can transfer your RRSPs and your RRIFs into your spouse's RRSP or RRIF or sometimes a registered pension plan for a financially dependent child or grandchild without any tax consequences. This defers the tax liability on those assets until your spouse, or your child or grandchild, disposes of those assets or dies.

And then turning to possible ways of reducing probate fees, you can avoid paying probate fees by excluding certain assets from your estate. For example, if you designated named individuals as the beneficiaries of your life insurance policies rather than designating your estate, the life insurance proceeds will not form part of your estate and will not be included in the calculation of probate fees. There are several other ways that you can exclude assets from your estate and reduce probate fees. For example, you can make your spouse the beneficiary of your RRSP or your RRIF. Or you can transfer your property to the intended beneficiary before your death. You might consider holding assets like real property or joint bank accounts or bank accounts jointly with your spouse or child, so that the property passes automatically to them on your death without having to go through your estate. You might consider creating a living trust that gives you access to income or capital during your lifetime but passes directly to the beneficiaries on your death. You might prepare multiple Wills if you have assets in more than one jurisdiction, or you might prepare two Wills, one that covers assets that require probate and one that covers assets that do not.

There are, of course, pitfalls to each of these strategies, so you'll want to make sure that you don't sacrifice your estate planning goals simply to reduce probate fees. I've seen too many instances where the tail is wagging the dog when it comes to probate estate fee planning, and you want to be careful that you keep these possible pitfalls in mind. For example, if you transfer your bank account into joint ownership with a spendthrift child, then that child may actually drain the account while you're still alive. And in that situation, paying the probate fees would have been a small price to pay to protect your savings from your child at the end of the day.

There are a number of other tax reduction strategies that you may want to consider in the course of planning your estate. For example, you might buy permanent life insurance to cover your estate's expected tax liabilities. Life insurance benefits generally are not taxable and adequate life insurance means that your estate will not necessarily have to sell non-liquid assets, like recreational property for example, to cover its tax liabilities. Another suggestion is to make charitable gifts in your Will. If these gifts are substantial, your estate will receive a valuable tax credit that will be applied to your income in your year of death and the prior year as well. Thirdly, take advantage of unused RRSP contribution room. If you have unused RRSP contribution room when you die, and you have a spouse who's aged 69 or younger, your executor or your executrix can make a contribution to a spousal RRSP within 60 days of the end of your year of your death. So your executor can then claim a deduction for the amount of the RRSP contribution on your terminal tax return.

I think that that sort of brings us to the end of this podcast, and it does outline the kinds of taxes that arise on death and considerations that underlie them. In the next podcast, when I will have Ian join us once again, I think what we'll do is we'll talk about two other important and often times more complex tax reduction strategies, that being the use of trusts and your own shares of a private corporation, if you have those kinds of assets, and the concept of estate freezes. Thanks very much for joining us today, and we look forward to speaking with you again in the future.

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