



Cookson Walker Consulting

Getting the Most from Your Estate

You've Worked Hard to Create Your Wealth. Don't Jeopardize It With Poor Planning.

By John Campbell

News of recent brokerage sales transactions have caused a number of brokers to review the impact of selling their brokerage on their retirement plans. This is also the ideal time to take a second look at your estate plan.

For most Canadians, an estate plan is the simple process of passing a home, an RRSP and some portfolio investments to a surviving spouse, or children. Insurance brokers have more complicated estates that may include shares of a private corporation and potentially the building where the brokerage operates. The nature and liquidity of these assets underscores the necessity for brokers to prepare estate plans.

The purpose of an estate plan is to: Guarantee that your financial needs are met during your life; make certain that any dependents are supported and protected; to ensure that your assets are distributed to your desired heirs in accordance with your wishes, and to minimize taxes or costs and maximize the amount available to pass to your heirs. These goals are important to all of us, however, finding the time to deal with such issues is difficult. A little time spent now to review or implement a plan will likely save money in taxes and professional fees and help ensure that your particular goals are met in the future.

Because individuals have different needs, family structures, assets and liabilities, each estate plan is unique, notwithstanding that the process for developing an estate plan includes the same steps for every person.

Creating an estate plan requires:

- Identifying what assets constitute your estate.
- Determining who will benefit from your assets.
- Assessing costs and tax exposure.
- Implementing strategies to take advantage of any tax minimization or deferral opportunities.
- Formalizing the estate plan.
- Reviewing the plan regularly, especially after major life events.

WHO BENEFITS?

The second step involves the process of determining who will benefit from your estate. The first beneficiary of the assets of your estate is yourself. A critical part of every plan is to ensure your assets are sufficient to meet expected needs and cushion the financial impact of your future plans. This requires a review of current income sources compared with current expenditures, as well as estimating the impact of various life events and short-term and long-term goals on your income and expenses. It is normal for some personal financial planning to be done comparing projected spending with anticipated income. This analysis can be very useful in determining the impact of major decisions, such as when to retire and the implications of major purchases, such as a cottage, on your estate.

Your assets may be required to satisfy more than your own needs; perhaps needed to provide for a spouse and dependents. Further, you may also wish for others to benefit from your assets, such as extended family members, friends or favourite charities.

If you own a brokerage, the shares of the brokerage are normally your largest asset. Unlike shares of public companies, there is less liquidity for a private company. Further, the value of a brokerage could be dramatically affected if its owner performs most of the management duties and is no longer alive. In these cases, the lack of proper planning can lead to a significant drop in the value of your estate. If your spouse or dependents are relying on the proceeds from the sale of the brokerage, it is imperative to have a plan in place to ensure that the business continues to operate with minimum interruption until it can be sold, and maximum value is incurred when the brokerage is sold.

If your intention is for family to operate the business, then the goals of your plan will be to ensure that those members who will run the brokerage are adequately trained (including obtaining property licensing) and the financial needs of surviving spouses and other beneficiaries who are not active in the brokerage are met.

When determining your plan, special consideration should be given if some of your children work in the brokerage, while others are employed elsewhere. The intention of most brokers is to treat their children fairly and even-handedly. However, care should be taken when considering allowing children who do not work in the brokerage to become shareholders. When devising a plan, it is ideal to avoid a situation where one child is operating the brokerage for another child who is benefiting as the owner or shareholder. This can lead to resentment and disharmony after you die. Remember you will not be there to resolve any disputes so the step of determining the allocation of your assets prior to your passing will avoid unnecessary family conflict.

COSTS AND TAX EXPOSURE

Unfortunately, an undesired beneficiary of every estate is the tax authorities. Current legislation in Canada provides two taxes that may occur upon death.

- ***Capital Gains/Income Tax***

Upon death, taxpayers are deemed to have sold all of their assets at market value. This means that a capital gain on any increase in value on all assets usually results.

Further, the value of all deferred plans, such as RRSPs and RRIFs, becomes fully taxable.

The only exception to the above rule is that the Income Tax Act allows assets to be transferred to a surviving spouse at cost, which defers the capital gain. A similar rule applies for the transfer of RRSP and RRIF accounts. However, this deferral is not permanent and the deferred capital gain or taxation of RRSP and RRIF accounts will be taxed when the surviving spouse dies.

- ***Probate Tax Fees***

Most provincial jurisdictions in Canada assess a probate fee or tax, which is based on the value of the assets that are distributed according to the will that is probated. For example, in Ontario probate fees are half of 1 per cent for the first \$50,000 and 1.5 per cent on the remaining value of assets. Most provinces do not have a maximum amount that can be charged to an estate.

Usually, the results of assessing your tax situation can be quite alarming. Brokers should review their situation to determine if any tax strategies are available that will minimize the amount of tax paid and maximize the amount that can be used by desired beneficiaries. Several tax-planning strategies exist and it is important to consult a tax specialist to ensure the right approach for your particular situation is taken.

ESTATE FREEZE

If a broker is fortunate enough to have accumulated more assets than he or she anticipated needing during their lifetime, a method to defer the capital gain upon death is to implement an estate freeze while still alive. The broker would only own shares of the brokerage with a "frozen" or fixed value. The value of these shares would not grow. The corporation would issue new common shares that will go to desired beneficiaries.

The benefit of this strategy is that the capital gain tax arising upon death is based on the value at the time of the estate freeze. Any growth subsequent to the estate freeze would be deferred until the common shareholder (beneficiary) sells the asset. This will reduce the tax that could be payable on the broker's death, by capping the size of the deceased's estate to the value at the time of the freeze.

In situations where a broker determines that his or her intended beneficiaries are not ready for direct ownership in the brokerage a trust can be established. The trust would hold the shares of the brokerage for the benefit of the intended beneficiaries, but, trustees, who could include the broker and trusted advisors or friends, would control the shares.

SPOUSAL TRUSTS

A trust is a separate legal entity that allows the beneficial owner of an asset to be different from the legal title-holder who controls the asset.

If an individual anticipates that his/her surviving spouse will have significant income (greater than \$60,000 per annum) before the income from the assets of the estate, then it may be useful for their will to establish a spousal trust. On the individual's passing, the will would transfer ownership of the income producing assets to the spousal trust instead

of directly to the spouse. A spousal trust is a separate entity that is subject to personal tax rates at the graduated tax scale. The tax savings of keeping the income generating assets of the estate in a trust could exceed \$10,0000 annually, compared with having the same income added to the surviving spouse's income and taxed in his/her hands.

Further, when the surviving spouse dies, the assets held by the spousal trust are distributed according to the terms of the will of the contributing spouse. This can also be a planning opportunity when there are children involved from other marriages.

If assets pass directly to your surviving spouse, the assets become the legal property of the surviving spouse. Their ultimate disposition will be determined by the will of the survivor. Placing the same assets in a spousal trust ensures that the ultimate recipient matches your intention.

A spousal trust may also be useful in situations where the author of the will is concerned about the surviving spouse's financial acumen. A will appoints an executor/executrix to control the assets of the trust. If a spousal trust exists, all income generated by the trust can be used for the benefit of the surviving spouse, however, if the surviving spouse is not the executor/executrix he/she does not have any control over the assets of the estate itself.

CAPITAL GAINS EXEMPTION

In most wills, assets are passed on for the benefit of the surviving spouse. As noted previously, this can be done on a tax-free basis. However, in certain circumstances it is beneficial for the executor to elect to have the gain taxed. When the estate includes shares of a brokerage that is a "qualifying small business corporation," it would be effective for the executor to elect to realize the gain, as it could be sheltered from tax using the deceased's lifetime capital gains exemption.

This will greatly help reduce the tax that would be payable when shares of the private company are eventually sold. The value of this election could ultimately save the surviving spouse \$115,000. It is important that the will identify that the executor can make any tax elections for the benefit of the estate or beneficiaries.

This election could also be used to take advantage of any capital losses that the deceased had accumulated.

GIFTS WHILE ALIVE

One way to reduce tax upon death is to present some of your assets as a gift to adult children while you are alive. This would ensure that any growth is not taxed as a capital gain on your passing. If the individual would like to control the assets during the remainder of his/her life, the assets can be transferred to a trust. The individual could be a trustee so that he/she has some control over the assets, but the beneficiaries would be the adult children.

The individual should be aware that any gifts are a disposition for tax purposes, so the gift of an asset with a large accrued gain could result in tax. Also, a gift is an irrevocable transfer. Once the asset is gifted, the individual does not have any beneficial entitlement to the asset.

PROBATE PLANNING

In some provinces, such as Ontario, probate fees are paid on the value of all the assets that are subject to the will being probated. There are several simple strategies to reduce probate:

- Ensure that RRSP and RRIF accounts designate an individual other than the deceased as the beneficiary. This will result in these deferred accounts passing to the beneficiaries outside the will and avoid probate.
- Ensure that specific beneficiaries are designated in life insurance policies. If the deceased or his/her estate is the beneficiary, then the payout from the insurance policy is included in the estate and may be subject to probate fees.
- A common and simple tool is to use joint ownership to control assets. The concept implies a right of survivorship, which means that should a joint owner of an asset pass away, the ownership would transfer to the remaining joint owners. In spite of the benefits of creating joint ownership, there are several pitfalls that must be considered.
- If an asset that has a large capital gain is transferred to joint ownership, the owner must ensure that he/she has not prematurely triggered the accrued gain on the asset for tax purposes.
- Further, joint ownership does not allow you to implement other tax planning strategies.
- In Ontario, the shares of private companies are not required to be probated. However, if those shares are included in a will that has other assets that call for probate, all of the assets are subject to probate. In Ontario, a common strategy is for an individual to have "multiple" wills. One will would deal with only private company shares, which would not be probated, and the remaining assets could be included in a will that would be subject to probate.

As you can see, there are significant benefits and potential savings to developing an estate plan. Once you have completed this project it is important that it be reviewed on a regular basis. As you progress through life your goals will change and your estate plan may require adjustment to reflect these changes.

Tax and Estate Planning professionals at Cookson Walker LLP can be reached at (416) 368-7990 or www.cooksonwalker.com.