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Portfolio Advisor

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The Great Wealth Transfer

Making the most of your legacy

History's largest transfer of wealth between generations is under way, with Canada's baby boomers expected to inherit $1 trillion over the next two decades.[1] If you want to ensure that it's more of a "great wealth transfer" to your family, rather than the tax man, it's important to plan in advance. The following strategies can help you protect your legacy to your family.

The Inheritance

If you are giving an inheritance, consider how exactly you are going to pass along your assets. Generally, there are four ways:

1. Making Outright Gifts During Your Lifetime

Gifting while you are still alive has some obvious advantages. It's easy, it can be satisfying to help your family while you're still around, and it's often tax-free. On the other hand, you have to be careful not to give so much that it affects your own financial well-being. Remember, people are generally living longer and you may also have higher health-care costs in the last decade or so of your life. And there can be tax consequences. For example, if you are selling an asset to give to your family, you may have to pay capital gains taxes on the sale.

2. Setting Up Family Trusts

Here's another way you can give assets to your family while you're still alive, while keeping some control and potentially reducing taxes too. With a family trust, also known as a "living trust," you can transfer assets that would otherwise be exposed to your higher tax rate into a trust for the benefit of your children, grandchildren, nieces, nephews and other family members. If structured properly, income earned within the trust, when used for the benefit of

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your beneficiaries, is taxed at their marginal tax rate, enabling them to earn a certain amount of tax-free income due to their basic personal exemption.

You can also place conditions on the trust – for example, that the income be used for pursuing post-secondary education or to cover living expenses for minors or dependants who may need assistance looking after themselves or handling money. Since you have to file a separate tax return for a trust, and usually hire someone to manage it, it's generally more worthwhile when you have more assets to put towards it.

3. Passing Along Assets Through Your Will

Your Will is the key legal document that ensures your estate assets are distributed according to your wishes, and it also names the individual responsible for carrying out your wishes (your executor or, in Quebec, your liquidator).

Through your Will, you can indicate how your estate assets should be distributed to your beneficiaries generally (for example, 50/50 to each of your two children), as well as more specifically (for example, one child gets the jewelry and another gets the art collection). The value of your legacy to your beneficiaries may be reduced by the tax liability that may arise on your death. However, there are ways to address this tax liability through insurance (see "The Retirement Fund" on the next page for more).

In addition to making outright distributions through your Will, you can also establish testamentary trusts, which allow you to pass along assets to beneficiaries without giving them control (the assets are managed by a trustee). For example, you can set up trusts to provide for disabled children, minor children until they reach the age of majority, or adult children who have trouble managing their own money. You can also set up trusts to protect their inheritance from creditors or a divorce settlement. Make sure you speak with a qualified legal advisor before exploring the asset protection options available to you.

4. Passing Along Other Assets Outside Your Will

Some of your assets can be transferred without going through your Will, thereby avoiding provincial probate tax (which can be considerable in most provinces other than Alberta and Quebec). One way to do this is through joint ownership, where the asset passes to a co-owner instead of going through the estate (not applicable in Quebec). Insurance policy death benefits and registered accounts (RRSPs/RRIFs) with named beneficiaries also bypass probate.

Please ask us for complimentary copies of our in-depth reports on the various ways to transfer your estate to your beneficiaries.

Are You Expecting to Receive an Inheritance?

Many pre-retirees are counting on inheritances to help fund their retirement. However, it's difficult to be sure when you will receive an inheritance, and how much it will be exactly. With increasing longer life spans, you may be well into retirement before you receive an inheritance, and it may be much less than you expect for any number of reasons, including a lack of tax planning. In reality, most inheritances received by Canadians are a fraction of what they had expected.

As a result, it makes sense to do what you can to maximize your own retirement savings, independently. And if you are fortunate enough to receive a large inheritance, make sure you consider how it can improve your retirement plan, whether it's by reducing debt or increasing savings in your Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA). For more information about incorporating an inheritance into your retirement plan, please contact us.

The Contingency Plan

Living Benefits

You may have big plans for your legacy to your family and the world. But sometimes, the unexpected can get in the way. Ensure you have adequate critical illness, disability and long-term care insurance – known as "living benefits." Living benefits can provide funds for unexpected health-related costs, so you can avoid dipping into assets earmarked for your legacy.

Powers of Attorney

Also ensure your Powers of Attorney are up-to-date. This is especially important because people, while generally living longer, are living longer with significant health issues. There are two types of Power of Attorney (or Mandate in Quebec): one for personal care should you no longer be able to make decisions about your care, and one for your property should you no longer be able to manage your financial affairs.

As a general rule, you should update your Powers of Attorney with your lawyer at the same time as your Will every few years, or when there's a significant change in your life. Also consider who you appoint as your attorney. Your family members may be experiencing health issues themselves by the time they need to carry out their responsibilities, so you may wish to appoint a professional attorney, or multiple attorneys.

Ask us for a complimentary copy of our special report, Mind the Gap: Canada's Baby Boomers Need Power of Attorney Planning to Protect Themselves.

The Retirement Fund

Your retirement savings may be a large part of your legacy to your family. But did you know that up to half of any remaining balances in your registered retirement plans, including your RRSP/RRIF, may be payable to the government in taxes? You can transfer your RRSP/RRIF to your spouse and, in certain situations, to your dependant children without tax consequences, but not to other beneficiaries. The top marginal tax rate is often applied to all remaining funds in your RRSP or RRIF when they are taken into income in your final tax return (or that of your surviving spouse). On a $300,000 RRIF account, nearly $150,000 may be payable in taxes, depending on your marginal tax rate.

To address this potential tax liability, consider RRSP/RRIF "tax protector" insurance. This involves purchasing a life insurance contract that will pay your beneficiaries, who may use the benefit to cover the tax liabilities on your estate. For many people, the cost of the insurance coverage is less than the benefit paid.

The Investment Portfolio

As with your RRSP/RRIF, you can transfer your non-registered investments to your spouse without triggering taxes. However, when you (or your surviving spouse) transfer these assets to another beneficiary on death, the tax man may come knocking. On death, the tax man considers your assets to have been sold at their current market value (even if they haven't actually been sold), which potentially triggers taxable capital gains. In addition to your non-registered investments, real estate other than your principal residence, as well as family heirlooms like art, antiques and jewellery, may also be taxable. To cover these tax liabilities, insurance is a potentially cost-effective solution, as it is with your retirement savings.

The Cottage

First of all, if you are planning to pass along a recreational property onto more than one child, consider how you can avoid any potential disharmony down the road. A formal co-ownership agreement that stipulates how your children will use the property and pay expenses can help reduce any possible conflict.

Also consider how you can address any capital gains taxes triggered when you it pass on. If you expect the property to significantly grow in value, you may wish to gift the property to your children during your lifetime. While your gift results in a disposition at current market value, triggering accrued taxable capital gains to you today, you can defer future capital gains and avoid probate taxes. You may also consider applying your principal residence exemption to your recreational property if you expect it to trigger greater capital gains. In addition, as with your investment portfolio, insurance may be a cost-effective way to cover the capital gains taxes, which your heirs may otherwise have to cover by selling the property.

For more information on business succession and other strategies for business owners, please ask us for a complimentary copy of The Business Owner's Guide to Wealth Management.

U.S. Taxes

If you own a recreational property in the U.S., also bear in mind U.S. taxes, at both the state and federal level. You can potentially avoid U.S. state probate tax by owning the property through a living trust. You can avoid U.S. federal estate tax if your U.S. assets (including real estate and stocks) are worth less than US $60,000, or if your worldwide estate is worth less than US $5.25 million in total, on death. If you are above these thresholds, consider strategies such as taking out a non-recourse mortgage on your property. This special type of mortgage reduces your U.S. taxable estate, dollar for dollar.

Please contact us to learn whether "tax protector" insurance is a cost-effective solution for addressing tax liabilities related to your registered plans and capital gains on your investments and other property.

The Business

A business may also be part of your legacy to your family. Your main concerns will include:

- Identifying and grooming your successor well in advance, and making alternate plans if realistically there isn't a qualified successor in your family.
- Distributing your estate fairly, but not necessarily equally, to any family members who won't receive a share of the business.
- Ensuring adequate retirement funding for yourself and your spouse through the use of special tax-advantaged strategies for incorporated business owners, such as Individual Pension Plans.
- Minimizing taxes on the sale or transfer of the business through strategies such an "estate freeze" which can allow you to transfer future tax liability on the growth of the company to lower-income family members and multiply the use of the capital gains exemption on the sale of Qualified Small Business Corporation shares.

[1] Canadian Inheritance Study, Decima Research, 2006

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