Estate Planning

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1 › Introduction

By planning for tomorrow today, you can retain more of your assets, protect your estate and leave a lasting legacy for your family. A common misconception is that only the wealthy need to concern themselves with estate planning. This misconception can result in significant unnecessary costs to the estate and additional burdens for survivors. In fact, just about everyone can benefit from the development of an estate plan. Young or old, wealthy or middle class, an estate plan can reduce the taxes and expenses of an estate, simplify and speed the transition of assets to the next generation and ensure that beneficiaries are protected.

The purpose of this publication is to provide an overview of the estate planning process and address the main elements of an estate plan. Since some of the issues addressed in this publication vary between provinces, this guide is only intended as a general reference. Your personal estate plan should be prepared with the assistance of professionals such as an estate lawyer (or notary in the province of Quebec) and an accountant. Ask your advisor for more information about the financial planning issues that may be relevant to your situation. Also, ask your advisor about preparing a financial plan.

It should be stressed that this publication is intended for a Canadian resident that is not a US citizen.

2 › Common elements of an estate plan

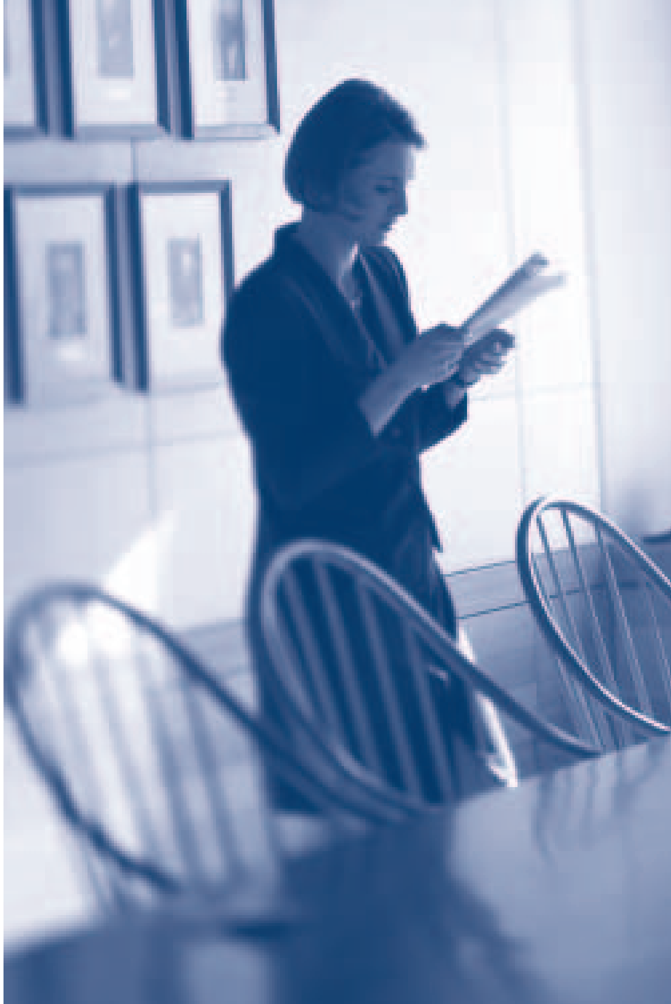
When most people hear the term estate planning, they typically think of their Will. While a valid Will is a fundamental component of any estate plan, there are several other elements that must be considered.

Given the wide range of objectives you may wish to achieve, proper estate planning requires careful consideration of many factors. Often, in an effort to minimize income taxes or avoid probate taxes, another objective is thwarted. For this reason it is important to weigh and balance the costs and benefits of different courses of action. Ultimately, the issues addressed in the Will are a reflection of all elements of the estate plan.

Common elements of an estate plan that must be considered include:

- Valid and current Wills for all adults in the family
- Different types of power of attorney for all adults in the family
- Evaluation of insurance coverage (i.e. do you have sufficient coverage?)
- Ownership structure (i.e. the use of Joint Tenancy agreements)
- Planning for incapacity
- Advanced estate planning opportunities (i.e. the use of Living Trusts)
- Taxes at death
- Planned gifting
- Pre-planned funeral arrangements

3 › Creating your estate plan



Typically, an estate plan need not require a substantial commitment of time or money. Most often, an estate plan can be constructed following six simple steps. Following these six steps will help ensure a plan that accurately addresses all of your estate issues:

1. Prepare an inventory of your assets and liabilities.
2. Define your estate planning objectives .
3. Evaluate your objectives based on your current situation (i.e. assets and liabilities)
4. Determine which actions are necessary to achieve your objectives.
5. Consult the appropriate advisors to implement the components of your plan.
6. Periodically review your plan.

STEP 1: PREPARE AN INVENTORY OF YOUR ASSETS AND LIABILITIES

A common problem that arises upon an individual's death is the determination of their assets and liabilities, and the location of their personal records. Frequently the deceased's assets are scattered about various bank accounts, safety deposit boxes and in their home.

Determining where these assets are and accumulating them in a central location is an unnecessary additional burden for the estate's executor/liquidator. To prevent this, you should prepare a summary of all the assets and liabilities that you and your spouse currently own. This information is necessary for various elements of your estate plan such as tax minimization and Will planning.

Assets that might be included are the following:

› Your home and vacation property.

› Your registered (RSP or RIF) and non-registered investments.

› Bank accounts.

› The face value of annuities and insurance policies.

› Personal property (i.e. cars, jewelry, art, etc.).

ESTATE PLANNING TIP

Time spent on Step 2 will help to ensure your estate plan accurately addresses your objectives as well as potentially saving you money.

- Pension assets (i.e. membership in a company pension plan).
- The current value of any business you own.

List all liabilities you currently have:

- Mortgage on your home and vacation property.
- Investment-related debt.
- Credit cards.
- Other personal obligations (i.e. family support).

In your inventory you should also document where the following items are located:

- Your original Will(s) and power of attorney/mandate.
- Birth and marriage certificates.
- Marriage contracts.
- Insurance policies.
- Real estate deeds.
- Location of safety deposit boxes.
- Details of pre-planned funeral arrangements.
- Names and addresses of your professional advisors.
- Location of trust documents.
- Names and addresses of liquidator(s)/executor(s)/trustee(s) and beneficiaries of your Will.
- Names and addresses of guardians/tutors for children (if not set out in your Will).

STEP 2: DEFINE YOUR ESTATE PLANNING OBJECTIVES

There are a multitude of potential estate objectives that might be considered in the development of an individual estate plan. Individuals must consider both personal and financial objectives that they may wish to achieve with their plan. While objectives will vary between individuals, here are some of the core questions that must be answered in the determination of your objectives.

a) Who will be the beneficiaries of the estate?

Determining the distribution of your estate can present a significant challenge if there are numerous potential beneficiaries. Beneficiaries can be classified as primary or secondary depending upon your intended order of distribution. Frequently, a primary distribution of your estate will include a small number of heirs such as your spouse and children. Often, the secondary distribution may include a larger number of heirs.

b) What impact will the estate plan have on your family?

This can be a significant issue, depending on the beneficiaries to be named in your Will. The distribution of an estate can be an emotionally charged period that may result in friction between family members. It may be beneficial to discuss your estate plan with beneficiaries to ensure your intentions are understood. In some cases it may be beneficial to consider more complex structures such as a Living Trust or a testamentary trust.

c) How long do you intend to provide support for your immediate family?

Typically, your estate plan will include an intent to assist your children and spouse. You may wish to provide this support for their lifetime or, perhaps, for a shorter duration. For example, you may only wish to assist your children until they have completed their education. Providing support for any minor children will also include the naming of a guardian/tutor.

d) Are there significant family assets that will need to be addressed?

If you have assets of significant value and complexity, such as a family business, plans should be made to determine how they will be distributed and maintained. In the case of a business, you should also ask the question, "Do the family members who will receive the business have the necessary skills to maintain it?" Other assets that can present a significant challenge may include a family cottage, fishing business, chalet or farm.

e) Is the minimizing of income tax and probate taxes important?

A comprehensive estate plan must attempt to minimize or defer tax both during an individual's life and upon death. Taxes triggered upon death (deemed disposition rules) as well as provincial probate taxes (negligible in the provinces of Alberta and Quebec) can result in the addition of a significant unexpected heir (i.e. the government) to your estate. While minimizing the estate's tax liability is important, tax minimization is only one aspect of the estate plan, and thus other factors must be considered such as:

- The person's desire to maintain control over their wealth during their lifetime
- The ability to control the disposition of property during their life and upon death
- Structuring their financial and business affairs in an orderly fashion to ensure proper distribution to their heirs

f) Do you want your beneficiaries to receive their inheritance immediately or at some future date?

Determining when beneficiaries will receive their inheritance can have an effect on your estate planning. For example, let's assume you have a 15-year-old child. Would you want them to receive their inheritance staggered over a number of years or paid to them immediately? The answer to this question will obviously depend upon the maturity of the child involved, the amount of money, and their experience with handling money.

g) Do you wish to leave any portion of your estate to charities?

In today's economic environment of declining government support for charitable organizations and their causes, there is a growing plea for support from the general public. There are various methods of passing assets to charities either before or at death, commonly referred to as "planned giving." Some of these methods can yield tax savings for the individual today while providing a long-term benefit to the charity. Ask your advisor for additional information on this topic.

STEP 3: EVALUATE YOUR OBJECTIVES BASED ON YOUR CURRENT SITUATION

Once you have clearly defined your estate objectives, the next step is to determine how your objectives can be achieved based on your current financial position. In conjunction with your objectives, you will need to consider other factors such as inflation, tax liabilities due to the deemed disposition rules and U.S. Estate Tax. The potential tax liabilities that arise at death are discussed in detail later in this publication.

Inflation

Inflation is a key issue that must be considered with any long-term planning such as retirement or estate planning. While we are currently experiencing a period of relatively

low inflation, ignoring its long-term impact could result in significant hardship for your surviving heirs. Even a modest rate of annual inflation can, over a period of time, significantly reduce a beneficiary's spending power.

For example, let's assume your intent is to provide your spouse with an annual income of $20,000 per year for his/her lifetime. To maintain your spouse's spending power 10 years from today their income would need to rise to $26,880 and to $36,120 in 20 years assuming a 3% annual inflation rate. In any case, inflation will serve to erode the benefit provided to your heirs.

Summary

Evaluating your estate objectives can be a complex task. This will depend on the number of estate objectives you identify and the size of your estate. In simple situations, such as a single individual with no dependents, you may proceed directly to the creation of a Will and the various types of power of attorney.

More typically, you will need to consider estate objectives in conjunction with your retirement objectives to properly assess your situation. This is best achieved through the development of a financial plan. There may be fee-only financial planners in your community who offer this service. Alternatively, you can speak to your advisor about the preparation of a financial plan. A financial plan will evaluate your estate and retirement objectives. It will also provide a detailed evaluation of your current situation and an outline of how your objectives can be achieved.

STEP 4: DETERMINE WHICH ACTIONS ARE NECESSARY TO ACHIEVE YOUR OBJECTIVES

Your action plan will result from the issues identified in your estate evaluation conducted in Step 3. The fundamental component of your action plan will likely be the construction of a Will or, if you currently have a Will, at least a review of the document. A significant number of potential issues can be easily resolved through a well-constructed Will. For example, tax planning opportunities such as the use of testamentary trusts and special provisions for beneficiaries can be addressed.

Other potential elements of your action plan may include changes in the legal ownership of assets (i.e. the use of Joint Tenancy agreements), the purchase of additional insurance to address estate preservation objectives and possibly the gifting of assets prior to death. It should be noted that Joint Tenancy With Right Of Survivorship (JTWROS) agreements do not apply for residents of Quebec.

STEP 5: CONSULT THE APPROPRIATE ADVISORS TO IMPLEMENT THE COMPONENTS OF YOUR PLAN

This step is crucial to ensuring your estate plan is properly implemented. You may require the assistance of several professionals such as: an estate lawyer (or notary in the province of Quebec); an accountant; a financial planner; possibly a trust officer; and your advisor. Make sure that as you seek out these advisors that you select individuals with an expertise in estate planning. Think of it this way, would you go to your family physician if you required heart surgery? Of course not, you would go to an expert. Why should your estate planning be any different?

Questions for your estate advisors

Questions you should ask potential estate advisors would include:

1. What degrees or relevant designations do you hold?
2. How long have you practiced in the estate planning area?
3. Have you implemented estate plans of similar complexity to my own?
4. What information can I provide to facilitate your implementation of the estate plan and reduce your work time? (Remember, you will likely be paying these advisors an hourly fee for their services.)
5. Is there any charge for an initial consultation? Do I have the option of an hourly fee or a flat rate for your services?

STEP 6: PERIODICALLY REVIEW YOUR PLAN

You should always be vigilant and cognizant that changes in your personal situation and in legislation may require changes to your overall estate plan. Periodic revisions are a must to ensure your estate plan is still achieving your objectives that were set in Step 2.

4 › Methods of transferring your estate

There are four methods of asset transfer that should be considered when creating an estate plan. Each of these methods has its advantages and disadvantages. The first method identified in the chart below (your Will) has been referred to on several occasions earlier in this document.

The Will represents the most common means of estate asset transfer, but all methods should be considered. Use of these alternative methods must occur in conjunction with a valid Will. Without a Will, the dissolution of the estate will be complicated by provincial intestacy rules. See Page 15 in the section titled "What if you die without a Will?" for further information on intestacy.

WILLS (PROBATABLE ASSETS)

A Will represents the most fundamental element in any estate plan. A Will is also essential to ensuring your wishes are carried out with minimum expense and delay.

A Will is a legal document signed by you and normally witnessed by two individuals who are present at the signing. The Will can be revised at any time in the future to reflect changes in your financial or personal situation.

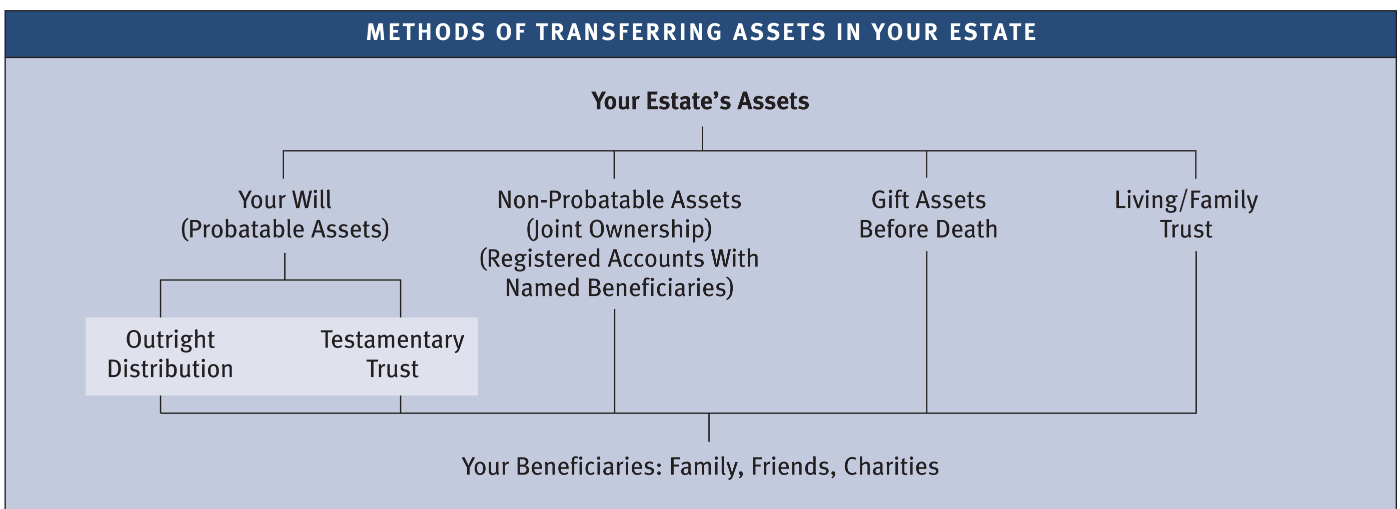
The instructions outlined in your Will only take effect upon your death and are in no way binding upon you during your lifetime. For example, if you indicate in your Will that a painting is to be left to your brother but at a later date decide you would like to sell the painting, your brother would not have a claim on the painting. If inclined, you may want to revise your Will at that point to provide your brother with some other asset.

While the four methods of estate transfer described below should be considered in an estate plan, the Will is a necessary document in all circumstances. A Will serves two basic purposes:

1. To ensure your property will be distributed to your beneficiaries according to your wishes
2. To appoint an executor (called a liquidator in Quebec), who is the individual or corporation that will act on your behalf and carry out your wishes

In addition to the above two items, a Will typically includes the following:

- An outline of the administrative powers of the executor, liquidator(s) and trustee.
- An indication of how you want your estate to be managed and distributed, which may include immediate distributions to your beneficiaries and/or the creation of a testamentary trust to allow distributions at a later date



- Naming of a guardian for your minor children (referred to as a tutor in Quebec)
- Instructions to minimize income taxes, if possible
- Specific instructions for the distribution of your personal effects as well as your wishes regarding burial

Your beneficiaries can be any person or entity (i.e. a charity) that you wish to name. In many provinces there are restrictions provided under provincial family law preventing you from excluding from the estate persons such as your spouse, children or anyone to whom you may be providing ongoing support.

TYPES OF WILLS

There are two types of Wills that can be created with a third option in the province of Quebec.

Formal Will

A formal Will is usually a typed document signed by you in the presence of at least two witnesses. These witnesses cannot be your beneficiaries or their spouses. Most formal Wills are normally created by a lawyer or notary and written in "legalese" to ensure your Will achieves your stated objectives.

There are pre-printed Will documents as well as software programs to produce a "do-it-yourself" Will, but you should be careful when using either of these alternatives to ensure the document does actually state your desired objectives.

Holograph Will

A holograph Will is written entirely in your own handwriting and is signed by you. It is not necessary to have a witness to your signature. Several provinces recognize this type of Will as being valid, but there are numerous potential pitfalls. For example, if any of the text in the Will is ambiguous or can be interpreted in a different way, the estate may not be distributed in accordance with your original intent. Use of a holograph Will is not recommended. If you prepare a holograph Will but a holograph Will is not allowed in your province, you will be deemed to have died intestate.

Notarial Will

This is only an option for residents of Quebec. A notarial Will is created by a notary and normally signed in the presence of only a single witness. The original copy of the Will is kept by the notary.

PREPARING A WILL

At this point in the publication it should be apparent that the creation of a Will that achieves your objectives and prevents undue difficulties for your heirs and executor/liquidator can be difficult, if created without the assistance of experts. Therefore, spending a few hundred dollars (possibly $400 to $500) to have an estate lawyer (or notary in the province of Quebec) assist you is money well spent.

ESTATE PLANNING TIP

It is generally recommended that you name an executor/liquidator who is one generation younger than you to ensure that they will be able to act on your behalf.

Before you sit down with an estate lawyer or notary to draft a Will make sure you do your homework. Make sure you have considered all elements of your estate plan, discussed the issues with your spouse and have considered all components of the Will (i.e. your selection of executor/liquidator(s) and trustee) before sitting down with the lawyer or notary. This will save the lawyer or notary time and ensure your Will accurately reflects your wishes. Remember the meter is ticking when you are in the lawyer's or notary's office so you don't want to leave important decisions until the last minute. It can be a costly visit!

How Often Should Your Will Be Reviewed?

Frequently people execute their Wills and file them away, never again to see the light of day, until their death. Big mistake! In some situations, an out-of-date Will can be worse than no Will at all. Your Will should be reviewed at least every two to three years to ensure that it continues to accurately reflect your wishes. More frequent review may be necessary as significant changes in your financial or personal situation occur (i.e. birth of a child).

Also, your Will should be revised if you move to another province; if there are changes in legislation; you marry or divorce; or if an executor/trustee or significant beneficiary predeceases you.

TESTAMENTARY TRUSTS

In addition to a direct or outright distribution of estate assets to beneficiaries, assets can be left to a testamentary trust for the benefit of your beneficiaries. A testamentary trust only takes effect at death. The creation of the trust is documented within the text of the Will.

A testamentary trust allows you to pass specific assets to beneficiaries without allowing them to gain control of the assets. The assets held in the trust are invested and managed by the trustee of the trust with income and capital distributed to the beneficiaries in accordance with your wishes as stated in the Will.

Often the trustee is also the executor/liquidator of the estate, although you may wish to consider a separate person to act in this capacity.

Typical situations where a testamentary trust might be used include:

- Spousal trusts—a trust established for the benefit of the surviving spouse for their lifetime. Commonly, remaining assets pass to the children on the spouse's death. This is an effective income-splitting opportunity since the income in the trust can be taxed at its own graduated tax rates separate from the spouse.
- Trusts for minor children—established to support the children until they reach the age of majority or beyond.
- Trusts to provide continuing financial support for disabled children.
- In Quebec, if you have minor children to whom you want to leave money, a trust is not required, but it may be beneficial—at least until they reach the age of majority. In Quebec, it is the responsibility of the tutor to hold and administer the funds for the minor child.

However, if you want to bequest assets to a minor and do not want the assets administered by the children's tutor then it would be wise to include this fact in your Will.

- Trusts for adult children—used to protect an inheritance from potential creditors or a divorce settlement. This use can also provide income-splitting benefits since income in the trust can be taxed at the trust's tax rate.
- Spendthrift trusts and trusts for family members with special needs.
- Insurance trust—proceeds from a death benefit of an insurance policy can be transferred to a trust. This arrangement can avoid probate taxes, offer the deceased some control over the asset and offer income-splitting opportunities.

NON-PROBATABLE ASSETS (JOINT OWNERSHIP)

One of the simplest forms of transferring assets from the estate is through the registration of assets in joint ownership. There are two ways of owning property with one or more persons. One is Joint Tenancy With Right Of Survivorship (JTWROS) and the other is Tenancy-In-Common.

Joint Tenancy With Right Of Survivorship (Joint Tenancy)

This form of ownership allows two or more people to own an asset together. All persons listed as joint tenants share ownership and control of the asset, and upon the death of one of the persons (i.e. a tenant), the ownership automatically passes to the surviving tenant(s). By passing directly to the surviving tenant(s), the asset does not form part of the estate and thus is not subject to provincial probate taxes (discussed later).

While this method of ownership can be effective in avoiding probate taxes, there are a number of complications that may result from its use. The following list outlines some of the potential problems with the use of Joint Tenancy:

- Each joint tenant has an equal, undivided interest in the whole property.
- Property that is held in Joint Tenancy by a bankrupt tenant is severed on bankruptcy.

The severing of the tenancy makes the arrangement a Tenancy-In-Common arrangement with the other tenants.

- Changing ownership of an asset may have tax implications. A change in ownership to Joint Tenancy is treated as if you have actually sold an equal portion of the asset to the other tenants. This may trigger a tax liability if a capital gain is recognized on the artificial sale. This transaction is referred to as the disposition rules in the Income Tax Act. Basically, the transfer of the assets to the Joint Tenancy is done at fair market value (FMV). Hence, if the asset has an unrealized gain it will be triggered on the transfer and a tax liability will have been created. The disposition rules also apply with transfers between spouses. However, instead of the asset being transferred at FMV, it is transferred at cost.

ESTATE PLANNING TIP

Consider all potential advantages and disadvantages when using the Joint Tenancy With Right Of Survivorship agreement. The avoidance of probate taxes is only one advantage for arranging your affairs is this manner.

Therefore, no gain would be triggered (i.e. no immediate tax liability).

- Changing ownership to joint tenancy may expose the jointly held asset to family law or creditor claims.
- The use of Joint Tenancy ownership may ultimately cause property to end up in the ownership of persons other than those who the deceased would like to see receive the property.
- Joint tenancy may, in some instances, be severed by legislation (i.e. joint ownership of matrimonial home with a person other than your spouse in Ontario).

The deceased cannot control the disposition of the jointly held property once they are gone. The property generally passes to the surviving joint tenant(s) regardless of the provisions in the deceased tenant's Will. Hence, it is important that the other joint tenant(s) added in Joint Tenancy are also the intended beneficiaries. Otherwise the asset may pass to an unintended heir upon death.

Note: Residents of the province of Quebec cannot use a Joint Tenancy With Right Of Survivorship (JTWROS) agreement since an automatic right of survivorship does not exist under Quebec law.

Tenancy-In-Common

A Tenancy-In-Common is another form of co-ownership. It is the ownership of an asset by two or more individuals together, but without the right of survivorship that are found in a Joint Tenancy. Unlike a Joint Tenancy agreement, co-owners in a Tenancy-In-Common arrangement can own equal or unequal interests in an asset. Thus, on the death of one of the co-owners, his or her interest will not pass to the surviving owner, but will pass according to the Will of the deceased. If the deceased

did not have a Will then the provincial intestacy laws would dictate the distribution regime.

Unlike Joint Tenancy, the assets held under a Tenancy-In-Common agreement will be subject to probate taxes because the assets would have passed through the estate of the deceased tenant.

REGISTERED ACCOUNTS WITH NAMED BENEFICIARIES

If you intend to leave your RSP or RIF to your spouse or any other individual, ensure that this person is the designated beneficiary on the account in order to minimize probate taxes. Also ensure that, when making a beneficiary election for your RSP or RIF, you consider any other disposition of your estate, either in a Will, or under a contract of insurance. It should be noted that currently Quebec residents cannot designate beneficiaries on registered accounts. However, they can provide designations via their Wills.

GIFTING ASSETS BEFORE DEATH

Without question the easiest method of transferring assets is to gift them to your heirs prior to death. Gifting is frequently used without the motivation of its estate planning merits, but simply to assist children and family members with activities such as a home purchase or business financing.

Gifting of assets can have potential tax benefits if the asset is given to a registered charity or if the asset was income producing, resulting in less taxable income. Be careful when gifting income-producing assets such as stocks or bonds. Your altruistic act may trigger an unexpected tax liability for you. Generally, gifting an asset to an individual (other than a spouse) is treated as a sale (at fair market value) thus triggering any unrecognized capital gain on the asset. Also, the income attribution rules will be applied if the gift is to your spouse or a minor child. Under this rule, the income earned on gifts to either of these persons will still be taxable in your hands (except for capital gains received by a minor child).

Another drawback to gifting is that you relinquish all control over the asset, which may not be an acceptable outcome. Finally, while gifting assets represents a simple method of transferring the estate as well as reducing probate taxes, like most things, it should be done in moderation. Before a gift is made you should ensure that by making the gift you do not jeopardize your own lifestyle. This is best evaluated within a comprehensive financial plan.

It is also possible to gift assets on your deathbed by using an enduring power of attorney or mandate (see page 21). Timing is everything with this strategy.

To learn more about gifting to charities ask your advisor for more information.

LIVING/FAMILY TRUSTS

The use of a trust in estate planning represents a slightly more complex method of asset transfer. The essence of a trust is that it is a relationship rather than a separate legal entity. This confusion arises from the fact that the Income Tax Act treats a trust as a taxpayer, requiring it to file a separate tax return annually.

However, this relationship is between the trustee, who holds legal ownership of the trust asset for the benefit of the beneficiaries, and the beneficiaries who are entitled to the use and enjoyment of the asset.

In the province of Quebec, the concept of the trust is slightly different from the other Common law provinces.

First, there is no division of ownership (legal and beneficial) under Quebec Civil Law.

Second, there is a concept called “patrimony”. Patrimony is basically the assets and liabilities of a person that can be valued and that could be subject to creditor claims if requested. Also, as per the Civil Code “every person has a patrimony that may be divided or appropriated to a purpose, but only to the extent provided by law”.

It is the concept of a “patrimony appropriated to a purpose” which enables a Quebec trust to avoid the discussion of trust property in terms of legal and beneficial ownership.

Therefore, the trust property of a Quebec trust constitutes an independent and separate patrimony whereby the settlor, the trustee or the beneficiary do not exercise any real rights in this property. In reality this trust property is ownerless.

Therefore, in Quebec, based upon patrimony, a trust results from an act whereby the settlor transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular person in which a trustee undertakes, by his acceptance to hold and administer.

The overall effect of this is that the Quebec trust operates in a similar manner as other trust in the rest of Canada.

In simple terms, a trust provides an intermediary between yourself and your intended heirs. By using a trust you can transfer ownership of an asset out of your hands, allowing your heirs to benefit from the asset and at the same time allowing you to retain control.

There are two types of trusts. An inter-vivos trust (living trust) is a relationship that is created during an individual's lifetime. The second type of trust is a testamentary trust, which is created on and as a consequence of the death of an individual (discussed in the Testamentary Trusts section on page 11).

A living trust can be structured to provide the person gifting the assets (i.e. the settlor) with significant control and flexibility over the timing and amount of assets distributed to the trust's beneficiaries (your heirs). Control of the trust assets by the settlor is derived from the trust indenture (document), not from controlling the assets directly.

There are many reasons to consider a trust during your lifetime, whether for estate or tax planning purposes, including:

- To provide long-term income and protection for minor children or dependents who are not capable of looking after themselves, or handling financial matters.
- To create a trust for charitable purposes.
- To provide secrecy on death (a probated Will is a public document).
- To achieve income splitting with family members in lower tax brackets for the income paid out of the trust—the income attribution rules apply through the trust so the benefit may be limited.

Note that all income retained in a living trust is taxed at the top marginal tax rate.

For additional information on Living/Family Trusts, talk to your advisor.

5 › What if you die without a Will?

If you die without a Will you are considered to have died "intestate." Unfortunately, many individuals believe that if they were to die without a Will their estate would simply pass to their spouse. While a spouse and children will likely end up with the estate's assets it is very likely it will not happen exactly as you would have intended.

Each province has its own set of intestacy rules that define the estate's beneficiaries and how much each is to receive. These rules are fairly simple in that they do not allow for any flexibility in how much and who will benefit from your estate.

Typically, the spouse will receive a preferential share of the estate ranging from the first $40,000 to $200,000 of estate assets. The balance of the estate is divided between the surviving spouse and children.

Most provinces do not recognize the common-law spouse status under their intestacy rules. This may result in a common-law spouse being left out of the estate entirely. However, in most provinces a common-law spouse may petition the courts for support as a dependent.

If the above issues are not enough to prompt you to create a Will, consider the following additional problems:

- Your entire estate will be subject to provincial probate taxes. These taxes can be significant depending upon the value of the estate and province of residence.
- A court-appointed administrator (called a personal representative in some provinces) will manage and distribute the estate.
- In Quebec, if you die intestate, your heirs, by majority vote, will have the opportunity to designate someone to act as a "liquidator" of your estate. Failing agreement among the heirs, the court may designate the liquidator. This process may result in disputes over who should be appointed, resulting in family tension and added legal expenses.
- Distribution to your beneficiaries could be delayed.
- Additional legal fees to settle the estate.

- Additional taxes payable since all assets do not automatically pass to the spouse (thereby losing some of the automatic spousal rollover).
- The court will appoint a guardian for minor children. This person may not be the individual you would have selected.
- In Quebec, the court will appoint a tutor for your minor children if you and your spouse have not made the required arrangements.

So perhaps the question that should be asked is "Why wouldn't you create a Will?" Too much time required? Too much money? If you compare it to the time and money your family will have to expend to settle your affairs, you may reconsider your opinion.

6 › Taxes at death

The old saying, "There are only two certainties in life—death and taxes," holds true even at death. There is no escaping it, but there are ways to lessen the burden of this unanticipated beneficiary called the government. While there are no true "estate taxes" in Canada there are three potential taxes or pseudo-taxes that may be incurred at death:

- Income tax due to the deemed disposition rules.
- Provincial probate taxes.
- U.S. Estate Tax on your U.S. assets.

ESTATE PLANNING TIP

Completion of a "family inventory" will simplify your executor's probate filing. Many firms offer a pre-prepared checklist. Ask your advisor for more information.

Consider naming specific beneficiaries for assets such as RSP/RIFs (in certain jurisdictions), insurance policies, segregated funds and pension plans to avoid paying probate taxes on these assets.

DEEMED DISPOSITION

In the year of death, a final (terminal) tax return must be filed by the estate's executor/liquidator that includes all income earned by the deceased up to the date of death. Also included in income at death is the net capital gain recognized under the deemed disposition rules.

The deemed disposition rules of the Income Tax Act treat all capital property owned by the deceased as if it was sold immediately prior to death. Thus, all unrecognized capital gains and losses are triggered at that point with the net capital gain (gains less losses) included in income.

The Income Tax Act does contain provisions to defer the tax owing under the deemed disposition rules if the asset is left to a surviving spouse or to a special trust for a spouse (qualified spousal trust) created by the deceased's Will. This provision allows the spouse or the spousal trust to take ownership of the asset at the deceased's original cost. Hence, no tax is payable until either the spouse or the spousal trust sells the asset or until the surviving spouse dies. The tax is then payable based on the asset's increase in value at that point in time.

RSPS AND RIFS

In addition to the potentially significant tax liability from recognized capital gains, it is also necessary to deregister (i.e. collapse) any registered assets such as RSPs or RIFs at the point of death. The full value of the RSP or RIF must be included on the deceased's final (terminal) tax return. There are exceptions to this deregistration requirement if the RSP or RIF is left to the surviving spouse, a common-law partner and in some cases to a financially dependent surviving child or grandchild.

An RSP or RIF can be transferred tax-free to a surviving spouse's own plan. Also, the RSP or RIF can be transferred tax-free to a financially dependent child or grandchild who is under age 18, even if there is a surviving spouse. In this case, the registered funds must be used to purchase a term-certain annuity with a term not exceeding the child's 18th year. For example, if a financially dependent 10-year-old child was to receive RSP assets from his deceased parent, an (18 – 10) eight-year fixed-term annuity would need to be purchased. Also, if there is a financially dependent child or grandchild that is mentally or physically infirm, the RSP or RIF funds can be transferred tax-free to the child's or grandchild's own RSP or RIF.

PROBATE TAXES

Upon death the executor of your estate will typically be required to file for probate with the provincial court. The estate's executor must submit to the court the original Will and an inventory of the deceased's assets. Upon acceptance of these documents by the court, letters probate (called "Certificate of appointment of estate trustee with a Will" in Ontario) are issued. This document serves to certify that the submitted Will was duly proved and registered in the court and that the administration of the assets of the deceased has been given to the executors for their administration of the estate.

With the executor's submission to the court, he/she must also pay a probate tax. This tax is based on the total value of the assets that flow through the Will (see page 9 for more details). The rate charged varies between provinces with some provinces having a maximum tax. All provinces except for Alberta and Quebec levy potentially significant probate taxes.

Probate is not required for a notarial Will in the province of Quebec, and for those that have other types of Wills drafted in Quebec the probate tax is very nominal.

In situations where the estate is extremely simple and does not require any involvement with a third party such as a financial institution, the Will may not need to be probated. As well, probate taxes can be reduced by using previously discussed strategies such as the naming of beneficiaries, Joint Tenancy With Right Of Survivorship agreements and the use of Living Trusts.

U.S. ESTATE TAX

In addition to the taxes payable in Canada, you may also be subject to a tax bill from the U.S. Government. Canadians that own U.S.-sourced assets such as real estate, corporate stocks and certain bonds and government debt are required to pay U.S. Estate Tax based on the market value of their U.S. assets at death. Any assets that are considered "U.S. situs" property (i.e. deemed to be located within the United States) will be subject to this tax. Most people do not realize that investing in the securities issued by a U.S. corporation such as IBM or Microsoft in their Canadian brokerage account may result in a U.S. Estate Tax liability for their estate.

Note that discretionary managed accounts where the individual directly owns U.S. situs securities will still be subject to U.S. Estate Tax, even though the buy and sell decisions are not made by the individual owner.

Changes to the Canada-U.S. Tax Treaty have reduced the number of Canadians that may be subject to this Estate Tax. For 2005, the tax rate charged on U.S. assets ranges from 18% to 47% of the taxable U.S. estate value. What has changed in the Tax Treaty is the amount of U.S. assets that are exempt from this tax.

Furthermore, due to sweeping U.S. tax law changes enacted in June 2001, the top U.S. Estate Tax rate will gradually decrease to 45% by 2007. The U.S. Estate Tax exemption amounts will also gradually increase to $3,500,000 US by 2009. There will be no U.S. Estate Tax for those who pass away in 2010.

However, without further legislative action, as strange as it may seem, all U.S. Estate Tax laws in place prior to the changes enacted in 2001, will be reinstated starting in 2011.

Under the rules now in effect, a Canadian resident can claim a unified Estate Tax credit of $555,800 US in 2005 against the Estate Tax owing. This means that there is no U.S. Estate Tax if the deceased's worldwide assets are $1,500,000 US or less.

Unfortunately, this credit is pro-rated based on the following formula:

$$\text{Pro-rated Estate Tax credit for 2005} = \$555{,}800 \text{ US} \times \left\{ \frac{\text{value of your U.S. assets}}{\text{value of your worldwide assets}} \right.$$

In addition to the changes to the tax credit, you are now able to claim any U.S. Estate Tax paid as a foreign tax credit against the tax payable in Canada attributable to the deceased's U.S source income in the year of death. Previously, the U.S. tax was not recognized in Canada, resulting in the double taxation of these assets.

For many individuals with significant net worth, U.S. Estate Tax will still represent a significant tax burden to their estate. Potential methods of reducing the total cost of U.S. Estate Tax include the following:

- Use life insurance to cover the U.S. Estate Tax bill allowing your total estate value to be maintained. In certain circumstances, it may make sense to have an irrevocable trust own the life insurance.

- Sell your U.S. assets prior to death. This is the simplest method of avoiding the tax, but timing is everything with this strategy as the sale could result in an immediate Canadian tax liability.
- Individuals with substantial U.S. holdings may wish to consider using a Canadian holding corporation since the assets would be owned by the Canadian corporation and not by the individual. However, holding U.S. real estate in a Canadian corporation may not work.
- Reduce the value of your estate below the $1.5 million US threshold.
- Hold shares of Canadian mutual fund corporations that invest in the U.S. market.
- Units of Canadian mutual fund trusts and pooled funds that invest in the U.S. market are also likely exempt from U.S. Estate Tax. However, tax experts have had varying opinions on these particular investments. Therefore individuals are encouraged to consult with a qualified tax advisor for a professional opinion on this issue.
- Hold the asset in joint ownership. This may serve to defer the tax on half of the property until the other tenant dies, assuming the surviving tenant can prove that he/she acquired their half interest in the asset using their own capital.

For more information on U.S. Estate Tax, speak with your advisor.

7 › Life insurance

Life insurance can play a significant role in your estate plan as it provides a solution to a wide range of potential objectives. In general, life insurance serves one of two purposes: either to create an estate for your heirs or preserve your existing estate. Generally, life insurance premiums are not tax deductible but the benefit paid to the estate (probate may apply) or a beneficiary (probate would not apply) is also not subject to income tax. Common uses of insurance include:

- To provide liquidity in an estate to pay off liabilities such as taxes or mortgages. This will ensure that non-liquid assets, such as a cottage or business do not have to be sold, but can be left to your beneficiaries.
- To establish a fund to provide income for an individual you wish to support, such as your spouse, children or grandchildren.
- To make a donation to charity.

BASIC TYPES OF LIFE INSURANCE: TERM AND PERMANENT

Term Coverage

Term insurance provides protection for a specific period of time. It pays out the benefit only if you die during the term of coverage. Term insurance is typically used to fund a short-term estate need such as paying off an outstanding mortgage, protecting the estate against an immediate shortfall or to prevent financial hardship by replacing lost income caused by the death of the life insured.

This coverage is usually offered as a five-, 10- or 20-year term after which time it may be possible to renew the policy at a new premium rate. This coverage is generally the cheapest coverage to purchase if it will only be necessary for a short duration. If the coverage will be required for a longer period it may be less expensive to consider permanent insurance options.

Term to 100

Term to 100 coverage provides long-term protection in your estate plan. This type of life insurance coverage often has a constant annual premium throughout your lifetime with the annual premium being higher than that charged for a five-or 10-year term policy. This policy will remain in force as long as you pay the annual premiums, but if the premiums stop so does the coverage. This policy has no cash value.

Permanent Insurance

Permanent insurance provides protection for your lifetime. As long as you pay the premiums, the death benefit will be paid. The majority of these types of products have a cash value or cash-surrender value.

Whole life

Whole life coverage is similar to Term to 100 coverage in that it is intended to remain in effect for your lifetime. In addition to the permanent insurance coverage, a whole life policy also includes a savings component. Therefore, the annual premiums you pay fund the insurance premium with the excess accumulated for the future benefit of you or your estate. Over a period of time the policy's savings component will result in the accumulation of a cash value to the policy (referred to as a cash surrender value).

Universal life

A universal life policy is a combination of term insurance and a tax-deferred saving's component. Your premiums fund the insurance coverage with the balance invested in various investment options that you select. The premiums can be increased to raise the amount of tax-deferred savings (with some limitations) or reduced to simply cover the cost of the insurance coverage. Premiums may be suspended if sufficient cash value has been accumulated in the policy to fund the insurance coverage.

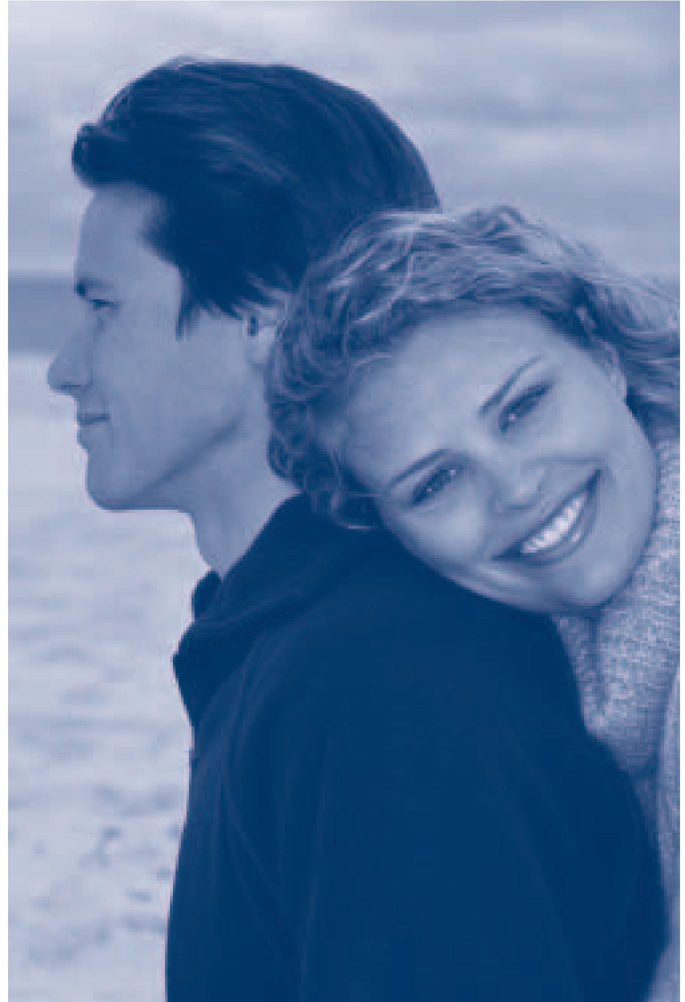
Insurance for Estate Planning Purposes

The use of universal or whole life insurance products rather than term insurance is the preferred option where the purchase of insurance is for estate purposes. Examples include having a life insurance policy that would cover estate taxes on death (capital gains generated due to the deemed disposition rules) or the ability to leave bequests without the advent of taxes payable.

As with all insurance products that are geared towards estate planning purposes, a thorough cost-benefit analysis should be performed in order to assess the appropriateness of the strategy.

How much Insurance is enough?

The amount of coverage you require will depend on your estate objectives and current financial status. As you age, you may find that the level of coverage you require declines or perhaps changes from short-term to permanent coverage. Determining exactly how much and what type of insurance is most suitable for your situation can be best assessed through the preparation of a financial plan and the aid of a life-licensed representative. The financial plan and a life-licensed representative can help you in the determination of both short- and long-term needs in conjunction with your overall financial objectives.



8 › Planning for incapacity

Throughout this document we have discussed the issues that should be considered when planning your estate. The final component of your estate plan should address potential situations where you may become physically or mentally incapacitated. This is achieved by creating an enduring power of attorney. Without an enduring power of attorney, your attorney (not necessarily your lawyer or notary) cannot act on your behalf during a period of incapacity until they receive court approval.

For Quebec residents, the enduring power of attorney document is referred to as a mandate (in anticipation of incapacity). In Quebec, a notary or lawyer can draft mandates. However, this is not a requirement. Mandates are also registered in a centralized registration system, if drafted by a lawyer or notary, to ensure the mandate can be easily accessed.

It is important to note that all mandates terminate if a court-ordered curator or tutor is appointed or the persons you appoint die before your death. You can revoke a mandate at any time, so long as you are mentally competent.

POWER OF ATTORNEY

The most common form of this document, a financial power of attorney, is also referred to as a power of attorney for personal property or financial decisions. The authority that you give the individual acting as your "attorney" (for Quebec residents, a "mandatary") can be either limited to specific activities or assets, called a "limited power of attorney," or can provide the attorney with wide-ranging control of your financial affairs called a "general power of attorney."

A power of attorney may be temporary or of indefinite duration, but in all cases the authority provided by this document ends upon death or incapacity. The appointment of a committee or guardian by a court order will also terminate a power of attorney.

ESTATE PLANNING TIP

Your power of attorney document(s)/mandate(s) should always be reviewed when writing or updating your Will to ensure consistency between the two documents.

ENDURING POWER OF ATTORNEY

It is important to note that the power of attorney document (general, limited or financial) will not be valid if you become mentally incapacitated unless it specifically states that the attorney's authority is to be maintained under this circumstance. Additional wording is necessary to ensure the document is considered enduring in subsequent mental incapacity. This is commonly referred to as an "enduring power of attorney."

Your power of attorney/mandate should be created with the assistance of a lawyer or notary to ensure it accurately reflects your wishes. If you require additional information on this topic, ask your advisor.

For British Columbia residents, there is now a representation agreement that will allow adults to appoint representatives. If the adult should lose mental capacity, these representatives can have authority to make decisions about the person's legal affairs, financial affairs, personal care and health care needs if necessary.

The representation agreement is an additional document that can be utilized alone or in conjunction with an enduring Power of Attorney. As always, it is prudent to have a lawyer review these documents prior to their implementation.

LIVING BENEFITS

Living Benefits are an important part of your insurance portfolio. You've worked hard to save and build your assets, so avoid having to liquidate them during your lifetime under unforeseen circumstances. Consider protecting your lifestyle and your peace of mind by obtaining the appropriate coverage. There are three main areas of coverage related to living benefits:

- Long Term Care
- Critical Illness
- Disability Insurance

Long term care

- Designed to subsidize any long term care needs, such as home care assistance or a stay at a private health care facility
- Allows the individual to pay for future potential costs while earning an income as opposed to diminishing an investment portfolio or laying the burden of those costs onto family
- Claims can be made once the insured cannot perform certain activities, such as dressing or feeding themselves
- After the initial waiting period, the insurer will begin to pay a daily stipend

Critical illness

- Provides peace of mind and the means to deal with the diagnosis and recovery of as many as 22 illnesses – including cancer, heart attack, stroke, and Alzheimer's disease—or a severe accident
- As medical science progresses, the chances of surviving a once fatal illness are increasing as is the individual's burden of funding the treatment
- The lump sum payment is used at the beneficiary's discretion. They might use it to pay for private treatment or to take a family vacation—it's their choice

Disability insurance

- Will replace your income if you are unable to work and you meet the definition of disability as outlined in your contract
- Definitions are very important—the better the plan, the broader the definitions
- Many people have group coverage through their employer but the definitions usually are not very broad, and when you leave your employer you lose the coverage
- Individual coverage will be there until age 65, no matter where you work
- Coverage is based on your job and income at the time of issue and will not be altered if you change to a more dangerous job or earn less income

Determining exactly how much and what type of living benefits insurance coverage is most suitable for you can be best assessed with the aid of a life-licensed representative.

LIVING WILLS

The provinces of Manitoba, Ontario, Quebec and Nova Scotia all have legislation allowing for the creation of what is commonly referred to as a living Will. Depending on the province, a living Will may also be referred to as a power of attorney for personal care, a mandate, a health care directive or proxy, an advance directive or a representation agreement.

The purpose of a living Will is to provide instructions regarding your medical care if you were to become incapacitated and unable to state your wishes. This document may indicate the type of treatment you may or may not wish to receive. A living Will should be created with the assistance of a lawyer or notary and discussed with your family physician and family members.

PRE-PLANNED FUNERAL ARRANGEMENTS

When funeral arrangements are pre-planned there is considerably less potential for stress, confusion and mistakes. Making arrangements for a loved one in a rush can cause additional pain and costs at a difficult time. For this reason, more and more Canadians are considering pre-planned funeral arrangements as part of their estate plan. This allows for family input, minimizes the chances of additional costs and ensures your wishes are followed without burdening family members. A pre-paid funeral arrangement can also provide a special tax exemption for the income earned within the arrangement, subject to limitations.

9 › Where do you go from here?

After reading this publication you will hopefully have gained a greater appreciation for the issues that exist in estate planning and are now motivated enough to act. Creating your own estate plan will not necessarily be an arduous task but does require a commitment of time and some money.

The following steps should be considered as you begin this process:

- Follow the six steps outlined in the "Creating your estate plan" section. The most important step is establishing your estate objectives. Take your time.
- If you require additional information in any of the areas discussed in this publication, talk to your advisor.
- Speak to your advisor regarding the completion of a financial plan. A financial plan will assist you through the evaluation phase of your estate plan, addressing Will planning and life insurance needs assessment within the context of your overall objectives.
- If you require additional insurance coverage, contact your life-licensed representative for assistance. A variety of insurance products from many of Canada's leading insurance companies are available through a life-licensed representative.
- Develop your estate plan with the assistance of your accountant, lawyer, notary and advisor. If you do not have a relationship with an accountant, lawyer or notary, ask your advisor to refer you to one.
- Contact your advisor to find out how services such as agent for executor, corporate executor, and trustee services can assist you in your estate planning needs.
- Implement your plan. The most significant hurdle facing you is time. Most often people set out with the best of intentions but never implement. If you have made it this far, make sure you complete the process.
- Finally, once your estate plan is complete you must recognize that you are still not finished. Your estate plan should be revisited every two to three years to determine if it is still in keeping with your objectives.

Notes

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