Until Death Do Us Part

Then everything can change ...

RBC Wealth Management

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Contents

Ensuring a Smooth Transition of Your Estate From Your Spouse to the Next Generation

The focus of many estate planning books, articles and resources is on transitioning wealth to the next generation and preparing children for future inheritances.

The majority of estate plans in Canada, however, involve a slight detour along the way to this transfer of wealth: the surviving spouse. These estate plans leave a deceased's assets to the surviving spouse with the expectation that this individual, upon their death, will pass the estate to the next generation. This process also allows for a deferral of Canadian income taxes until the surviving spouse's death.

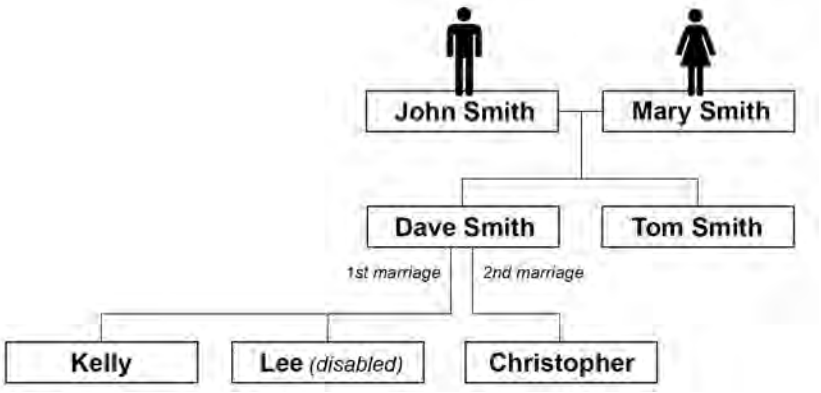
When preparing your estate plan, you should ask yourself a series of questions, including:

- Is my spouse prepared to be the first heir?
- Will my wishes be carried out by my surviving spouse?
- What if my spouse remarries?
- Should I draft my Will in a manner that takes advantage of the tax deferral or in a way that adequately reflects my current wishes?

These questions are often overlooked as most couples revert to the common and simple strategy of leaving everything to the surviving spouse.

Meet John and Mary

Take, for example, the Wills of John and Mary Smith, married for the last 30 years and parents of two adult children, Dave and Tom. Dave has two children, Kelly and Lee, from his first marriage and one child, Christopher, from his current marriage. Providing for Lee, who suffers from a severe disability, is a priority for John and Mary. John recently inherited $5 million from his father's estate, allowing him and his wife the freedom to retire.



John and Mary's current Wills leave all their assets to one another. Upon the surviving spouse's death, the assets are divided equally between Dave and Tom. Mary is inexperienced in managing finances, leaving John to take care of everything related to money.

Dave works as a tradesman and although he is a very hard worker, he and his wife spend freely on travel and clothing and have saved little for their future. John and Mary are concerned that the assets they leave Dave in their estate may be mismanaged. They are also worried that if Dave passes away and leaves his estate to his wife, she may exclude her stepchildren from her Will, thus depriving Kelly and Lee of Dave's estate and the estate of their grandparents'.

Tom is a high income earning salesman with sound financial acumen. Unfortunately, he has separated from his wife on more than one occasion.

John and Mary's assets consist of a primary residence, joint non-registered investments, Registered Retirement Savings Plans (RRSPs), Tax Free Savings Accounts, and a life insurance policy on John's life. John and Mary have named each other as executors on their Wills.

There are some traps that could result in different outcomes than what John and Mary envisioned which will be examined further. This RBC Special Report provides some tips on how to ensure your wealth passes from your surviving spouse to your children while reflecting your wishes.

The information is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a lawyer or accountant, as applicable, before acting on any of the information in this Special Report.

1. Leaving Assets to a Spouse

There are several ways to leave assets to a spouse with the intention that the estate will eventually flow through to the next generation.

1.1 Mirror Image Wills

A mirror image Will is the default estate plan for many families. With a "traditional" family unit, creating a mirror image Will is often straightforward and routine. These Wills usually include provisions for the entire estate to be transferred to the surviving spouse on the first death. In the event of a joint disaster or upon the death of the second spouse, the Will directs the entire estate to be divided equally between the surviving children.

A mirror image Will attempts to ensure that the estate distribution scheme remains consistent regardless of the order of death of the spouses. However, it can be a leap of faith because a mirror image Will won't guarantee that a deceased's wishes will be followed.

In general, if one spouse dies leaving their entire estate to the other spouse, the surviving spouse can change their own Will to leave the estate to a new spouse or to beneficiaries other than the couple's surviving children. In most provinces and territories, if the surviving spouse remarries, the existing Will is automatically revoked and intestacy laws would apply in the absence of a new Will[1].

For U.S. citizens living in Canada, this strategy may have a negative impact on planning for U.S. Estate Tax and should be carefully considered. Alternatives may need to be implemented.

This point is illustrated well in a case* where 90 year old Jane, a widow, married 40 year old Joe and drafted a new Will that disinherited her children and left her estate to Joe. The court ruled that Joe exercised duress and that Jane did not have testamentary capacity to draft a new Will and as a result the new Will was invalid. However, the marriage was valid and as a result, the marriage revoked Jane's original Will and Jane died intestate. Joe was able to inherit the majority of Jane's estate under the intestate laws and the spouse's preferential share rules.

* Names have been changed and circumstances altered

Statistics regarding estate litigation have not been tracked historically. In Ontario, data is starting to be collected. Based on unofficial data gathered for 2012/2013, it appears that approximately 1 in 9 estates are contested in court.

Provinces and Territories where a Will is revoked by a new marriage (unless the Will is made in contemplation of the marriage)

	BC	AB	SK	MB	ON	QC	NS	NB	PEI	NL	NW Terr	YK Terr	NU
Will revoked upon marriage	No	No	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Even if there is no new spouse or new Will, the surviving spouse can give away inherited assets *during their lifetime* to other individuals. Moreover, the surviving spouse might not be experienced in managing finances, resulting in a significant decline in the estate assets. The surviving spouse might also have solvency or creditor issues, resulting in a potential claim by these creditors on the estate assets.

Children or others might contest the surviving spouse's Will in court believing they were entitled to certain assets left by the first spouse according to the original plan. Contesting a Will in court can be an expensive, lengthy process and may not render the results a deceased intended to achieve when drafting mirror image Wills.

Let's go back to John and Mary. If John dies first, there may be nothing, other than a sense of moral obligation, stopping Mary from revoking her Will and changing the beneficiaries of her estate or gifting some of the assets away during her lifetime. (The same concern would exist for Dave and his wife if they have mirror image Wills.) If Mary remarries, how can John protect his assets and ensure they pass to his children while also providing for Mary during her lifetime?

There are alternatives to mirror image Wills that you may wish to consider.

Mirror Image Wills

Advantages

- Simple and straightforward
- Relatively inexpensive to prepare
- Allows for tax to be deferred until surviving spouse's death

Disadvantages

- Surviving spouse's Will could be revoked upon remarriage
- Doesn't prevent surviving spouse from distributing the estate before death
- No guarantee children will receive the estate

A case* that illustrates the need for an explicit agreement is where the mother and father prepared mirror image Wills. Upon the mother's death, one of the children became estranged and had a fallout with her father. Subsequently, the father changed his Will to reduce the daughter's share of the estate. The daughter argued that her parents had mutual Wills and that the father was precluded from changing her share in the estate. The judge rejected the daughter's assertion and held that there must be some agreement in place, other than the mirror image Wills, to conclude that mutual Wills existed.

* Circumstances have been altered

1.2 Mutual Wills (this concept is not recognized under Quebec law)

Like mirror image Wills, mutual Wills are an estate planning tool. Mutual Wills are based on an explicit agreement between the spouses that following the death of one of them, they will not change their Will to defeat their current joint intention[2].

It has been repeatedly insisted in case law that:

(a) The agreement for mutual Wills must satisfy the requirements for a binding contract and not be just some loose understanding or sense of moral obligation;

(b) It must be proven by clear and satisfactory evidence; and

(c) It must include an agreement not to revoke the Wills.

If done properly, a mutual Will agreement may prevent a surviving spouse from changing the terms of their Will and disinheriting their surviving children in favour of a new spouse or other beneficiaries. However, a significant problem with a mutual Will is that it is virtually impossible to monitor or reprimand a surviving spouse who accelerates spending and depletes the estate.

John and Mary may wish to consider entering into a mutual Wills contract whereby they agree that the surviving spouse will not revoke or change their Will after the first spouse dies. They would need to hire an experienced and qualified lawyer because this lawyer might have to provide evidence in court to determine if the mutual Wills are enforceable. John and Mary may also wish to receive independent legal advice when preparing these Wills.

Mutual Wills

Advantages

- Prevents surviving spouse from changing his or her Will
- Allows for tax to be deferred until surviving spouse's death

Disadvantages

- More expensive than mirror image Wills
- Doesn't prevent surviving spouse from distributing the estate before death

The concept of Joint Tenancy with Right of Survivorship does not exist in Quebec. In Quebec when joint ownership of property occurs, each co-owner's share would be dealt with according to the directive in their respective Wills. It is therefore important to consider those assets in which there is joint ownership and make an appropriate disposition of that property in your Will.

1.3 Joint Assets

Many couples hold most of their assets in joint tenancy with right of survivorship. Joint tenancy between spouses is a sensible and convenient way of holding property that reflects a couple's shared efforts and ensures that the pool of their assets passes to the surviving spouse with a minimum degree of effort and cost. Joint ownership with right of survivorship can be used for purposes including simplifying the administration of the estate and minimizing probate.

There are a number of *potential* problems associated with owning your assets in joint tenancy with right of survivorship:

- The surviving joint tenant can give the property away during their lifetime rather than passing it on to their surviving children upon their death;
- The surviving joint tenant can remarry and give this property to his or her new spouse (and/or the children of his or her new spouse) upon their death;
- The property could be subject to a claim by the creditors of the surviving joint tenant; and
- Assets that are jointly owned with the right of survivorship do not flow through the estate of the deceased, so estate planning tools such as testamentary spousal trusts cannot be used for these assets.

To overcome some of the drawbacks of owning assets jointly, you may wish to consider owning assets in your name alone. This sole ownership allows the assets to form part of your estate, thus giving you the option of using various planning strategies such as testamentary spousal trusts.

Under Quebec law there is no requirement for probate. A Will prepared by a Notary requires only final searches from the Quebec Bar Association and the Chamber of Notaries. However a Will prepared by a lawyer or done in any other form would need to be approved by the court. The only fees incurred in these circumstances would be those charged by the Notary or lawyer to complete the process.

Joint Assets

Advantages

- Simplifies administration of the estate
- Minimizes probate
- Allows for tax to be deferred until surviving spouse's death

Disadvantages

- Doesn't prevent surviving spouse from distributing the estate before death
- Joint assets could be claimed by creditors
- Precludes use of certain estate planning tools

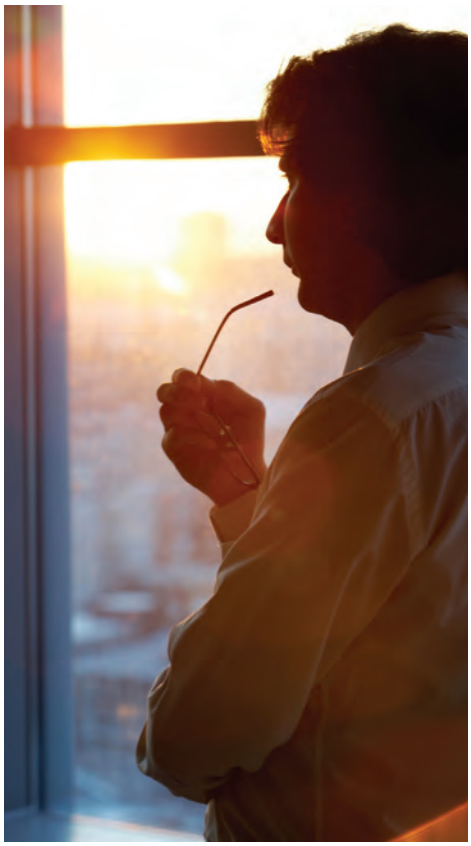
1.4 Testamentary Spousal Trusts

Another way to provide a more assured inheritance for your children is to create a testamentary spousal trust. This trust is established for the benefit of the surviving spouse through provisions in the Will of the deceased spouse. When the first spouse passes away, his or her assets are transferred to the testamentary spousal trust on a tax-deferred basis.

Under this structure, the surviving spouse is the only person allowed to receive income and capital distributions from the trust. When the surviving spouse passes away, the remaining assets go to the beneficiaries outlined in the Will of the first deceased spouse.

John may find that the testamentary spousal trust is the ideal structure to ensure his estate planning goals are met if he is first to die. On John's death, his assets would roll into the trust on a tax-deferred basis and provide income only to Mary during her lifetime. When Mary passes away, the assets remaining in the trust would be paid out only to Dave and Tom (or their survivors). This way, if Mary remarries after John's death, the spousal trust would protect John's assets and ensure they would not pass to Mary's new spouse or any other possible heirs.

However, John should be aware of certain factors regarding testamentary spousal trusts prior to implementation. For one, the assets that John and Mary own jointly, such as the primary residence and certain non-registered investments, will be solely owned by Mary when John passes away and will not be transferred to the trust[3]. These assets would be transferred under the terms of Mary's Will assuming John passes away first.



A Will under which a spousal trust is created will generally allow trustees to encroach on the trust capital for the benefit of the spouse. These powers allow the trustee to use some discretion to make capital disbursements directly to the spouse. John might want to consider carefully under what specific circumstance he would want Mary to be able to receive amounts of capital from the trust. Without proper planning, a situation may arise where Mary may ask the trustee(s) to make a large capital distribution to her. Once Mary receives this capital, the assets become Mary's property to use, enjoy, and bequeath as she wishes. To prevent large capital distributions, John's Will should restrict the circumstances under which the trustee(s) may exercise their discretion to make capital encroachments for Mary's benefit.

Additionally, when drafting the provisions of a testamentary spousal trust, it is important that the provisions adhere to the rules set out in the *Income Tax Act*. Otherwise the trust could be considered "tainted" and consequently would not qualify for the tax-deferred rollover of the deceased's assets to the trust. For example, John cannot include a condition that if Mary remarries, she can no longer receive income from the trust, nor can he have the trust distribute income or capital to his sons during Mary's lifetime.

The 2014 Federal Budget proposes to eliminate the graduated tax rates that currently apply to testamentary spousal trusts which would reduce the tax benefits of these trusts. Even if these tax benefits are eliminated, the testamentary spousal trust may still be useful as an effective estate planning tool to provide for your spouse.

Testamentary Spousal Trust

Advantages

- Prevents surviving spouse from giving away estate before death
- Surviving spouse's financial security assured, as is transfer of wealth to next generation
- Remarriage of surviving spouse does not affect the trust

Disadvantages

- Increased professional costs for trust
- Risk that tax deferral is denied if *Income Tax Act* rules are not respected
- Joint assets become sole property of surviving spouse and cannot form part of trust
- Assets forming part of the testamentary spousal trust may be subject to probate

2. Leaving Assets to Someone Other Than a Spouse

Couples usually leave their estate to the surviving spouse, an advantageous move thanks to tax rules that allow assets to roll over to a surviving spouse on a tax deferred basis. This tax deferred transfer can be achieved by leaving assets to a spouse directly or through a testamentary spousal trust. The rollover is also possible when registered assets such as RRSPs or Registered Retirement Income Funds (RRIFs) have a spouse named as the beneficiary. The tax liability is only triggered when the surviving spouse dies.

If you have children from a previous marriage, you might wish to leave them some assets in your Will. You'll need to ensure that the estate distribution scheme in your Will dovetails with the provisions of any prenuptial or postnuptial agreement. In the absence of any such agreements, ensure that your Will does not seek to frustrate your spouse's matrimonial property claims. Estate planning for blended families requires careful consideration and may incorporate some of the strategies discussed in this RBC Special Report in appropriate circumstances[4].

If you wish to leave assets to someone other than a spouse, you should be aware that this may trigger an immediate tax liability rather than a tax deferral. However, this tax result should not deter you from achieving your goals and distributing your estate as you wish. Here are some strategies that may help to minimize the tax impact.

2.1 Choose and Allocate Assets Wisely

Not all assets are treated equally for tax purposes at the time of death. As a result, you may wish to consider leaving the assets that have the biggest tax hit to your spouse and distributing assets with a smaller tax liability to other beneficiaries. For example, at the time of death, the entire balance of a registered retirement plan (RRSP/RRIF) is included in income and taxed at your marginal tax rate unless you name a spouse as a beneficiary of your plan. It is also possible to get a deferral if a qualifying dependent child or grandchild is named as beneficiary. Special rules apply for a disabled dependant including the ability to have a rollover to a Registered Disability Savings Plan.

On the other hand, a non-registered investment portfolio is subject to tax on taxable capital gains at time of death unless the assets roll over to a spouse. Furthermore, the proceeds of a life insurance policy are not ordinarily subject to any tax. Choosing the right asset for the right beneficiary can be tricky. You may choose assets of equal value for each beneficiary, but due to the different tax treatments applicable to those assets, their eventual values may vary, causing inequality between your beneficiaries.

For example, after much thought, John decided to leave some assets directly to his sons. The majority of his assets are in joint names with Mary so John made Dave the beneficiary of his $1 million life insurance policy and Tom the beneficiary of his $1 million RRSP. The rest of his estate would pass to Mary as she is the surviving joint tenant on these other assets.

Despite what he thought, John was actually not treating his sons equally. Since no other assets are flowing to the estate to pay the tax liability on the RRSP, Tom would have to give up about $500,000 of the RRSP to cover the tax liability while Dave would receive the entire $1 million life insurance payment tax-free.

John can distribute his assets in a much more tax efficient way. For example, he should consider designating Mary as the beneficiary of his RRSP. Next, he should consider naming both Dave and Tom as beneficiaries of his life insurance policy. Finally, if he wishes to leave a larger inheritance directly to his sons, then he should consider moving $1 million from his joint non-registered account into a non-joint account and pass the proceeds of that account to Dave and Tom in his Will.

If John is concerned that his grandchildren won't end up with much of his estate, he should consider the use of a testamentary trust to hold Dave's share of the estate or leave certain assets in a trust for the benefit of the grandchildren. These types of testamentary trusts are discussed further in the Appendix.

While you should not let the potential tax consequences drive the financial planning process, it is important to consider the impact of taxation on gifts and inheritances.

2.2 Gifts to Children During Your Lifetime

After considering your overall retirement needs and ensuring you will have sufficient assets to meet those needs, you may consider gifting some of your assets to your children during your lifetime and then leaving the residue of your estate to your surviving spouse. Consider whether there will be any tax implications from making the gift during your lifetime and any impact that the gift may have on your income and cash flow.

For alternatives to making lifetime gifts to your children, please refer to the discussion on inter vivos trusts in the Appendix.

2.3 Charitable Giving

You may wish to incorporate charitable giving in your estate plan and provide lump sum gifts to charities in your Will. Charitable donations generate donation tax credits that offset all or a portion of the taxes payable in the year of your death and the year prior to your death[5]. Consider using the donation as a planning tool. It can allow you to leave some of your estate directly to your children and, if a tax liability is triggered as a result, you can use the donation tax credit to reduce the tax impact.

You may also consider drafting your Will in a way that gives your executors the flexibility to make donations in the most efficient tax manner. For example, donating marketable securities that have appreciated in value allows you to eliminate the taxable capital gain and still benefit from the donation tax credit. The following example illustrates the consequences of selling securities in the estate to make a donation or donating securities directly from the estate:

	Donate cash from shares	Donate shares directly
Fair market value of donation (a)	$50,000	$50,000
Adjusted cost base at death	$10,000	$10,000
Capital gain at death	$40,000	$40,000
Taxable capital gain	$20,000	$0
Tax on capital gain @46% * (b)	$9,200	$0
Tax savings from donation tax credit (c)	$23,000	$23,000
Total cost of donation = (a) + (b) – (c)	**$36,200**	**$27,000**

* assumed marginal tax rate of 46%

In this example, the estate is ahead by $9,200 thanks to the executor's decision to donate the shares to a charity rather than donating the cash proceeds from the sale of these shares.

If an executor only wants to donate cash, he or she should sell securities that have a capital loss rather than a gain and then donate the proceeds to the charity. This way, the capital loss would offset capital gains elsewhere in the estate.

Charitable Gift Fund

You have several options to consider when making a charitable gift during your lifetime or in your Will:

- You could give a gift directly to a charity.
- You could give a gift to a private or public foundation.
- You could set up an RBC Charitable Gift Fund during your lifetime. This is a donor advised fund offering the benefits of a private foundation without the related administrative complexities. An RBC Charitable Gift Fund is essentially a private endowment fund within a public foundation. The RBC Charitable Gift Fund is easy to establish and manage, cost effective, and provides you with the flexibility to meet your charitable giving goals during your lifetime and potentially after your death[6].

2.4 Life Insurance

You can use life insurance in a number of ways to provide estate plan flexibility.

Life insurance could provide cash flow to your family in the event that you pass away while your children are still young. Life insurance proceeds could also provide funds to meet the tax liability triggered at the time of your death if you leave your assets to someone other than a spouse or on the death of the surviving spouse when the tax deferral ends.

You may also use life insurance to equalize between children or when estate assets are not sufficient to meet your desired goals. When structured properly, life insurance may reduce your overall taxes and, when combined with a charitable gift strategy, it can also magnify the power of your gift.

As part of any financial planning strategy you may be considering, you should speak to a licensed insurance representative about how you can incorporate life insurance into your overall estate plan.

As part of their estate planning strategy, John and Mary should review their existing life insurance coverage to determine if it continues to meet their needs. While John is considering naming his sons as beneficiaries of his life insurance, he should evaluate how this change would impact his overall estate. It may be preferable to name the estate as beneficiary if his Will already includes testamentary trusts in favour of the children. These options should be carefully examined, along with other alternatives, with his professional advisor.

Business owners have additional planning needs and should consider having a business succession plan that addresses the business needs and the surviving spouse's needs as he or she may be involved in the business[8].

3. Non-Financial Considerations

When preparing your surviving spouse to deal with your estate and ensure a successful transition to the next generation, some of the most important steps may not be financial in nature. The key steps may focus more on the responsibilities, relationships and processes with which your spouse should be familiar. Consider some of the following tips to make the transfer and management of your estate as easy as possible for your spouse.

3.1 Family Inventory

A good first step in developing an estate plan is to compile a comprehensive list of information pertaining to your family's accounts (banking, investments, etc.), advisors, assets, pension information, and insurance policies. This helps ensure that all assets are accounted for. Share the content of this list with your spouse and discuss the details. This can be a valuable exercise so that he or she becomes familiar with what to expect at the time of your death when starting to manage your estate[7].

It is also important to consider your digital legacy and how your surviving spouse will be able to deal with it. Your digital legacy includes: your electronic documents, online currency, photos, videos, records, reward programs, email accounts, domain names, social media profiles, writings, blogs, digital personas, avatars, and balances in your online accounts. A list of your digital assets and how to access them can be useful for your surviving spouse and may reduce the administrative burden of dealing with this aspect of your estate.

3.2 Introductions to Advisors

If you and your spouse share the same professional advisors for your banking, investments, taxes and legal matters, then continuing these relationships after your death should be seamless. However, if your advisors only have a relationship with you, consider introducing them to your spouse, and possibly other family members, as part of your estate plan. These introductions will allow your surviving spouse to continue working with advisors who know your history and are familiar with your planning. These relationships may help facilitate a smooth estate administration for your spouse and can ensure that any planning you began during your lifetime is continued or completed after your death.

3.3 Financial Plan

A current financial plan is important to ensure that life goals will be met. Involving both spouses in the financial planning process can mean that they are more likely to understand each other's needs, goals and concerns. It can provide peace of mind to a surviving spouse who is neither familiar nor comfortable in dealing with financial matters.

Since Mary leaves all money matters to John, reviewing a financial plan with John will give her a better understanding of the family's assets. She will see the family's financial position today and in the future, and she'll be able to discuss her concerns.

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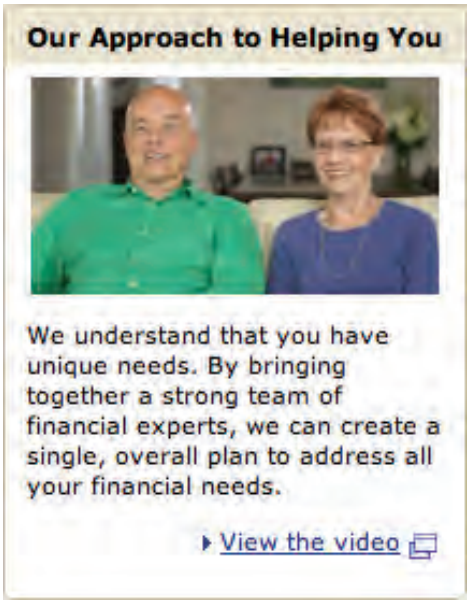

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www.rbcwealthmanagement.com/canada.html

A financial plan is not a one-time exercise. As circumstance change, it is important to review and adjust your financial plan as necessary. For instance, when one spouse passes away, the surviving spouse should update their financial plan based on their new situation.

3.4 CHOOSING THE RIGHT EXECUTOR

An executor is the individual or institution appointed in the Will who will administer the estate. Administration of an estate includes preparing an inventory of assets and liabilities, paying off the liabilities, and distributing the remaining assets as required under the terms of the Will[9]. The executor must settle the estate in a timely and even-handed manner according to the intentions stated in the Will, and must also comply with the provincial/territorial laws governing the estate[10].

When choosing an executor, you should carefully consider not only the importance of an executor's duties and responsibilities but also the willingness, knowledge and ability of the potential executor to act practically and effectively upon your death. An executor is accountable and legally liable for his or her acts of administration. Unfortunately, many executors are unaware of the scope of the role to which they have been appointed.

A common practice is for each spouse to consider the other as their respective executor, as in the case of John and Mary. However, a spouse may not always be the best choice. They are often the most affected with grief following death as well as overwhelmed by the myriad of decisions with which they are suddenly faced. Funeral arrangements alone can be a cumbersome task, not to mention all the other responsibilities involved in being an executor.

An individual can name someone other than a spouse as executor, or someone as a co-executor to act jointly with the spouse. Co-executors simply share the responsibility and become equally bound and responsible for all the duties of the executor.

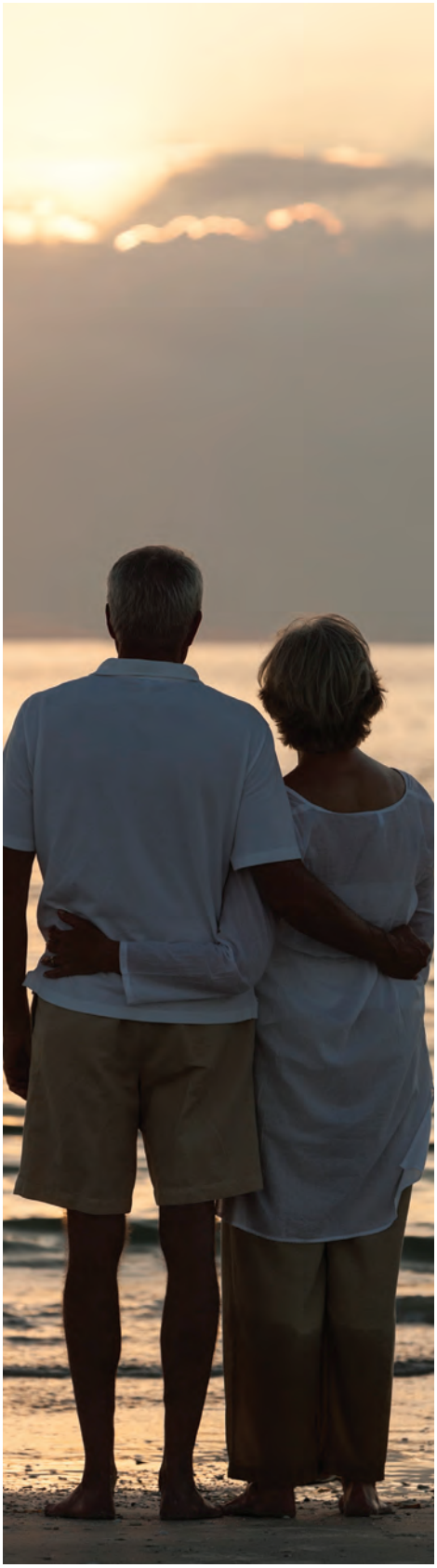
Here are some alternatives to consider when choosing an executor or co-executor:

a) **Family Members:** You may choose to name a family member or your children as executor or co-executors of your estate. When naming a family member keep in mind the person's age in comparison to your age and their residence and proximity to you. Be sure to ask your family member if they would be willing to act as executor and if they understand what it means.

b) **Professional:** A professional such as your trusted accountant or lawyer can be named as executor or co-executor with your spouse or other family member. Typically the professional is bound by a greater duty of care and held to a higher degree of accountability for any professional services rendered, especially given that they charge a fee for the execution of their duties.

c) **Trust Company:** A trust company is a corporation that has the advantage of not growing old, dying, or becoming incapacitated. Trust companies are highly regulated and are held to the highest degree of accountability under the law. Trust companies charge a fee for their services. They employ a wide

In Ontario, an executor is called an estate trustee with a Will. In Quebec, an executor is called a liquidator.



variety of professionals and have the expertise to discharge the duties of estate administration, including legal and tax work, in a timely and efficient manner.

There is no obligation to act as an executor, but once the executor has demonstrated his or her decision to act by carrying out duties or tasks relating to the estate, the executor becomes legally liable for his or her actions. An executor has the right to renounce his or her appointment as executor or may decide to delegate various duties to a third party. While he or she may delegate, the executor retains responsibilities.

To avoid the potential delays and costs associated with an executor renouncing their appointment (choosing not to act), it is advisable to have a discussion with the individual you wish to appoint as your executor, (or your back-up choice) before you draft your Will. This helps ensure that the person you choose will be willing to accept their duties and responsibilities if they are required to act in the capacity of executor at some point in time. It is also advisable to name an alternate executor in your Will in case the executor is unable to act or has predeceased you.

An executor who accepts the responsibility of settling an estate may be overwhelmed by the tasks to be completed, the time constraints and the experience and knowledge required to deal with the complexities of the role. As mentioned earlier, the executor may delegate some tasks to an Agent for Executor such as a professional or a trust company but will always retain final decision-making authority and full legal liability for the work delegated to the third party[11].

3.5 Communication is Paramount

If your spouse will be the first heir of your estate and potentially your executor, it is imperative that you have open and regular discussions about your intentions, goals, and plans to allow him or her to be familiar and comfortable with the tasks they will face.

It is equally important that your surviving spouse is familiar and comfortable with your professional advisors so they are able to continue your planning and meet your goals and objectives. Having these discussions during your lifetime may help alleviate any misunderstandings and problems that may arise in settling your estate and give you peace of mind that your goals and objectives will be met while your spouse will be better positioned to be the first heir of your estate.

3.6 Your RBC Advisor's Role

RBC works with clients and their independent legal or tax advisors to plan their estate to help achieve personal objectives and maximize overall wealth. Our specialized financial advice includes estate planning solutions, succession planning from a business and personal perspective, wealth management, financial planning, personal retirement planning, trustee service, philanthropy and insurance. Please contact your RBC advisor for more information or visit http://www.rbcwealthmanagement.com/canada.html for an introduction to an RBC advisor.

John and Mary's Final Decisions

With the help of their advisors, John and Mary decided to allow their non-registered assets to flow through their Wills and to include testamentary spousal trusts in their Wills to provide for the surviving spouse while protecting their assets and passing them to their children. John named his children as the beneficiaries of his insurance policy to ensure they had some financial flexibility upon his death. John also acquired a new insurance policy where the death benefit would pay into a Henson Trust for the benefit of Lee (Henson Trust discussed in the Appendix). John and Mary named each other as beneficiaries of their RRSPs. They also decided to name a trust company as executor of their estates. This gave them the comfort of knowing that the administration of their estates would be done in a professional and a timely manner.

The couple went through the process of completing a comprehensive financial plan, offered by their RBC advisor, which gave them both a better understanding of their financial position. This also helped clarify their financial responsibilities so that when one passes away, the administration of their assets will be less of a burden. This exercise included communicating their intentions to their children and introducing each other to their trusted advisors. By openly communicating their estate goals and proactively deciding on their estate administration, John and Mary have ensured they are each prepared to manage their hard-earned assets when the first spouse dies.

Appendix

In addition to the ideas discussed in this RBC Special Report, there are various strategies that you may consider when leaving assets to your children or grandchildren. These strategies are discussed in the appendix below. The following strategies would also apply if you are leaving assets in your Will to other family members such as nieces and nephews.

1. Considerations When Gifting or Leaving Assets to Children

There are three major concerns that may come up when leaving assets to your children or grandchildren. There are also several potential solutions.

1.1 Gift or Inheritance Could Become Matrimonial Property

Depending on the province of residence, matrimonial property claims may apply to assets left to your children and to the income generated by these assets. For example, if Tom deposits his inheritance into a joint account with his spouse or uses the funds to purchase a matrimonial home, the joint account or the home may be subject to a matrimonial property claim and division if he divorces his wife.

Children receiving an inheritance or a gift should keep these assets separate from assets held jointly with their spouse and not inadvertently contribute these assets to the marriage. It is also important to consider drafting cohabitation agreements or prenuptial agreements where appropriate.

1.2 Spendthrift Beneficiaries

One common concern among parents is the fear that their children may spend their inheritance carelessly without planning for their own or their family's future. Teaching children financial responsibility and money management should start at an early age.

1.3 Creditor Claims

Another common concern for parents is exposing any gifted assets or inheritances to their children's creditors. As part of their estate plan, parents often search for ways to provide their children with some protection while allowing for flexibility and access to funds. It is essential that you speak to a qualified legal advisor regarding any creditor protection options available to you.

2. Trusts

There are several different trust structures you may wish to explore to solve the three problems described above.

2.1 Inter Vivos (Living) Trusts

You can transfer assets to an inter vivos trust during your lifetime and name your adult children as beneficiaries. You must appoint a trustee, whose responsibilities are governed by the trust agreement. These include administering the trust in the best interests of the beneficiaries and investing the trust assets prudently. In some cases, you could be one of the trustees. When

drafting the trust agreement, you could include terms which limit the access your children and their spouses will have to the assets. This structure may also offer creditor protection for your children.

When you transfer the assets to the trust, there will be a disposition for tax purposes, which may result in a tax liability for you. Any income earned in the trust may be taxable to the children (subject to attribution rules). Depending on your reasons for setting up the trust and the way in which the trust is structured, it is possible that once you transfer assets to the trust, you may no longer have access to the funds for your own personal use.

2.2 Testamentary Trusts

In your Will, you could create a separate testamentary trust for a portion of your assets, naming your children and grandchildren as the beneficiaries. You could specify in your Will that the capital and/or income of the trust can only be paid in certain circumstances (for example, when a beneficiary reaches a certain age). These conditions could protect the assets from the children's reckless spending habits, and from their spouse and creditors.

The 2014 Federal Budget proposes to eliminate the graduated tax rates that currently apply to testamentary trusts which would reduce the tax benefits of testamentary trusts. Even if these tax benefits are eliminated, the testamentary trust may still be useful as an effective estate planning tool to provide for beneficiaries.

2.3 Henson Trusts

In our example, Mary and John have indicated that providing for Lee is a priority for them. Depending on their province of residence, an option for them may be a Henson Trust, with Lee named the beneficiary.

For the trust to be effective, the trustees must have absolute discretion to distribute income and capital from the trust as they see fit. They must also have absolute discretion to withhold the income and capital. The beneficiary of a Henson Trust gains no vested right to the income or capital under the trust.

John could ensure Lee is provided for by transferring assets to a Henson Trust created in his Will. Assuming the trustee has absolute discretion of distribution, Lee may still be able to receive provincial disability support payments despite being a beneficiary of a trust with a large amount of assets.

From a tax point of view, since the trust was created in the Will, any income earned and retained in the trust would be subject to marginal tax rates (subject to 2014 Federal Budget proposal to eliminate the marginal tax rates). Dave could be named as a trustee and could make withdrawals as needed to fund Lee's medical treatment, education and living expenses. Any income from this trust that is distributed to Lee would be subject to his marginal tax rate.

While this concept is not recognized in Quebec civil law, in practice the use of a fully discretionary testamentary trust that would otherwise qualify as a Henson Trust appears to be accepted by the court if properly structured.

3. Annuities

An annuity helps solve many of the problems that arise when leaving assets to heirs. During your lifetime or at your death, you could use your assets to buy your children or grandchildren annuities, providing a guaranteed income stream for life. Annuities ensure a gift or inheritance is not mismanaged, and is protected from marital and creditor claims. Premature death is a significant risk related to an annuity, and life insurance is an effective way to hedge this risk.

Endnotes

[1] For more information on intestacy laws, ask your RBC advisor for a copy of the RBC Wills and Will Planning publication.

[2] The case of Edell v. Sitzer, 55 O.R. (3d) 198 provides a concise summary regarding mutual Wills. The court noted:

Where the requirements for the application of the doctrine are satisfied, the survivor will not be permitted to defeat the agreement by revoking his or her Will after the death of the other. This result is achieved by the imposition of a constructive trust on the survivor's estate for the benefit of those who were intended to benefit under the agreement. The fundamental prerequisite for the doctrine is that there is an agreement. The agreement must satisfy the requirements for a binding contract.

[3] Not applicable in Quebec.

[4] For more information on Estate Planning for Blended Families please ask your RBC advisor for RBC Perspectives Magazine Volume 2, Issue 1 to review the article titled "Estate Planning for Blended Families."

[5] The 2014 Federal Budget proposes to provide more flexibility in the tax treatment of charitable donations made in the context of a death.

[6] Ask your RBC advisor for more information on the RBC Charitable Gift Program.

[7] For more information, ask your RBC advisor for a copy of the RBC Family Inventory publication.

[8] For more information on Business Owner planning, ask your RBC advisor for a copy of the RBC Perspectives Magazine Special Business Owner Edition, Volume 1, Issue 3.

[9] Visit our website at http://www.rbcwealthmanagement.com/estateandtrust/_assets-custom/pdf/41842ExecutorChecklist.pdf to review the executor checklist.

[10] For a copy of RBC Executor's Kit and Estate Settlement Guide, ask your RBC advisor or visit our website at http://www.rbcwealthmanagement.com/estateandtrust/

[11] For more information on RBC's Agent for Executor Services, visit our website at http://www.rbcwealthmanagement.com/estateandtrust/estate-services.html

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