Case Study: Tax Planning on Death

Learning Objective:

- Identify issues and planning strategies that are appropriate to a client's family situation and the property to be distributed to family members
- Understand the tax and legal consequence of death
- Formulate appropriate estate planning strategies to mitigate the effect of the tax implications at death
- Explain how tax-deferred rollovers and the capital gains exemption can be advantageous

The Facts

Tom died at age 62 last week, while on a solo canoeing trip in Algonquin Park in northern Ontario. He was survived by his second wife, Gwendolyn, age 60, and his two adult sons, Lawrence and Alexander.

Tom was the sole shareholder of TomCo a Canadian-controlled private corporation at the time of his death. When Tom retired from TomCo, a year prior to his death, his two sons (ages 23 and 24) who had worked for many years with him in the business, took over management of the company. Tom was an artist and TomCo continues to own Tom's original artworks as well as the copyright on reproductions of limited edition prints and art cards. At the time of his death, Tom's estate consisted primarily of the following:

ASSET	FAIR MARKET VALUE	ADJUSTED COST BASE
House (jointly-owned with spouse)	$800,000	$420,000
Cottage	$400,000	$180,000
Non-Registered Stock Portfolio	$280,000	$242,000
RRSP – Mutual Funds	$235,000	N/A
Term Deposits (Non-Registered)	$80,000	$80,000
TomCo common shares	$880,000	$1,000

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Tom had only nominal income this year, although he was carrying forward $35,000 of allowable capital losses from the prior year due to a failed property investment.

Tom's will provides for the non-registered stock portfolio, as well as the term deposits, to be held in a spousal trust for the benefit of his spouse, who has independent sources of income. She is to receive all income from the trust and has a liberal right to encroach on capital, at the discretion of the trustee, with the residue passing to Tom's sons at her death. As well, the house goes to Tom's spouse, by reason of joint ownership with rights of survivorship, and the spousal trust is the beneficiary of the RRSP.

The will specifies that the cottage property is to be sold at Tom's death (none of the other family members want it) and the proceeds are to be paid outright to his spouse. The shares of TomCo are to be placed in a trust (or two separate trusts, at the discretion of Tom's executor) until the sons reach age 30. At present, the shares generate about $100,000 of net income annually. As each son reaches age 30, his shares are to be distributed outright to him. If one son should die before attaining age 30, his portion of the shares automatically pass to his surviving brother (or the trust for him). The shares qualify for the lifetime capital gains exemption, and neither Tom nor his sons have ever utilized any of their exemptions.

Question

Assume the perspective of Tom's executor and suggest three strategies that you might undertake to minimize taxes otherwise payable in the hands of Tom, his estate, or his heirs. Explain the benefits of each recommendation.

Reference

- *257 Advanced Estate Planning Study Guide (Section 2.7)*
- *Wealth Planning Strategies for Canadians, 2019 Edition (Chapter 21)*
- *Estate Planning with Life Insurance, 6th Edition (Section 2.4)*

Solution

The named-beneficiary on the $235,000 RRSP may be considered a poor choice from a tax perspective as the tax-deferred rollover is not available to a spouse trust. However, the fact that Tom's wife is beneficiary of the estate could possibly open the door to tax relief. Depending on the circumstances, the executor may be able to exchange the spousal trust's right as beneficiary of the RRSP for proceeds from sale of the cottage (equal value). Tom's executor and Gwendolyn would have to file a joint election to treat the RRSP proceeds as though they had been payable to Gwendolyn directly, qualifying them for the rollover.

The fact that Tom had little earned income in his year of death, but $35,000 in carried-forward allowable loses opens the door to other post-mortem tax planning. On transfer of the private company shares to a trust for Tom's sons, $879,000 of capital gain will be triggered in Tom's hands for his year of death. $848,252 (2018 amount) of that gain can be sheltered by Tom's LCGE, leaving $30,748 of gain ($15,239 of taxable capital gain) unsheltered. This gain could be offset for tax purposes by $15,239 of the carried-forward allowable capital losses, leaving $19,761 of the losses unclaimed at this point.

Normally, it would be most practical to do a tax-deferred rollover all of the non-registered stock portfolio into the spouse trust at its ACB of $242,000, avoiding triggering the realization of $38,000 of capital gains ($19,000 of taxable capital gain) in Tom's terminal tax return. However, there is still $19,761 of unused carried-forward allowable capital losses to be claimed. The executor could elect to “opt out” of the rollover on part of the shares, triggering $19,000 of taxable capital gains in Tom's hands and allowing the spouse trust to receive the shares with a bumped-up ACB. This benefits the spouse as her ACB on the shares would be averaged up, reducing her future tax consequences associated with the disposition of the shares.

The cottage could possibly quality for some or all of Tom's principle residence exemption; however, a full analysis would be required to determine if this would be tax efficient as the home currently has a larger accrued gain.

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