CLU 257

Advanced Estate Planning

2020 Edition, Version 2.2

Advocis

Advanced Estate Planning - CLU 257
Course Book

2020 Edition, Version 2.2

by

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Advocis The Financial Advisors Association of Canada

STEP Canada

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CLU Program, 2020 Edition, Version 2.2

Preface

The material contained in this Course Book provides an introduction and background for the assigned readings for Study Units 1, 2, 3, 4, 5 and 7. Assigned readings are found in two textbooks: *Estate Planning with Life Insurance,* by Glenn R. Stephens, LL.B., and *Wealth Planning Strategies for Canadians* by Christine Van Cauwenberghe, B.Comm., LL.B., CFP, TEP. The assigned reading for Study Unit 6 is included within the unit itself.

It is expected that each candidate has some professional experience and educational background in many of the topics included in each of the study units. The assigned reading material is intended in large part to serve as a review of topics of which the candidate should already have knowledge and understanding.

The study units are designed to help the candidate pull together broad areas of information and apply them in an integrated fashion to client cases that approximate real-life practice. As would be the case in actual practice, it is expected that each practitioner may have more detailed knowledge in his or her area of expertise. Those candidates with a background in law will know the rules and formalities to be followed in order for a will or power of attorney to be legally binding. Those with a tax and accounting background will know the deadline for filing estate tax returns and making income tax payments. The financial planner will be able to project spending and wealth accumulation; determine funding requirements for retirement, dependents and estate purposes; and predict estate value. Trust officers will be intimately familiar with the details of estate administration and managing the assets of an incapable person, and the duties and obligations of attorneys, trustees and executors. The insurance professional can structure insurance solutions to fund obligations on death and achieve estate planning objectives and preserve wealth. While these are all aspects of estate planning, they are not the complete picture. This course provides an overall perspective of multiple aspects of estate planning so that each professional understands the context within which his or her work is performed. The extensive use of case studies is intended to allow a candidate to analyze client situations that include a variety of information, identify the salient items, and propose solutions or determine where issues arise that would require consulting a practitioner from another field.

As was noted in previous courses, while many of the relevant laws or rules in provincial jurisdictions are similar, jurisdictional differences may nonetheless exist that significantly affect a client’s situation. In many cases, the Course Book and assigned readings will highlight these instances; however, the reader is responsible for learning the specific law applicable in his or her jurisdiction, and must not rely on this material for the provincial or territorial specifics relating to their practice. For the purpose of examinations, the answers to questions will not require any specific provincial or territorial details beyond either the content of this material, or information that may be provided in an examination question itself.

Study Directions

The course is divided into seven study units, with the final unit devoted to case studies.

Required Texts

Text references in this course book are to:

- *Estate Planning with Life Insurance,* by Glenn R. Stephens, LL.B.; and
- *Wealth Planning Strategies for Canadians* by Christine Van Cauwenberghe, B.Comm., LL.B., CFP, TEP

Unit review questions and answers

You will find a number of questions at the end of each study unit. Suggested answers are provided after each set of questions. We encourage you to attempt to answer each of the questions before you refer to the answers. These questions are intended to assist you in your study efforts. They are not the kind of question you will encounter on the assignments and course exam.

Glossary

Key terms are defined and listed alphabetically at the end of this course book.

Advocis Learning Environment

Upon registration, you will receive an email which shows you how to access the Advocis Learning Environment (ALE). All instructions, deadlines and reading assignments will be located here.

If you have not received this information, please email info@advocis.ca.

Course Requirements

Online Assignments

Candidates are required to complete two online assignments.

- Each assignment is worth 20% of the overall course grade.
- The assignments are based on the content found in the course textbooks. Each assignment will require narrative responses to each question.

Ethics and Professional Standards Module

Candidates are required to complete the *Ethics and Professional Standards* module. Refer to the ALE for completion details.

- The Ethics and Professional Standards module is worth 20% of the overall course grade.

Course Exam

After completing both assignments and the Ethics and Professional Standards Module, candidates are required to complete the Course Exam. This three-hour proctored exam will be online and held at an assigned time. Refer to the ALE for details.

- The Course Exam is worth 40% of the overall course grade.
- The exam will require narrative responses to each question.

Course Grade Breakdown

Assignment 1	20%
Assignment 2	20%
Ethics and Professional Standards Module	20%
Final Course Exam*	40%
Total	**100%**

*A minimum grade of 50% on the course exam is required to pass the Advanced Estate Planning course (CLU 257).

If you score less than 50% on the course exam, your final overall course grade will be the grade you receive on the final exam only, (assignment and ethics module grades will not be included).

A minimum final overall course grade of 60% is required to pass the course.

Administrative Inquiries

Problems logging on, accessing the Advocis Learning Environment,

Requests for registrations, book shipments, equivalencies, membership, marks, exam information. Please contact Member & Client Services at:

Phone: 1-877-773-6765

E-mail: info@advocis.ca

Course Content / Industry-Specific Inquiries

Problems or clarifications regarding course content please contact our course consultants at:

Email: educontent@advocis.ca

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Unit One: The Estate Planning Process

Knowledge Objectives

Upon completion of this unit the student will:

- Understand the estate planning process
- Understand how the estate plan fits into the client's overall situation
- Know the common problems associated with poor communication
- Explain the problems that may result from failure to consider future events.

Skills Objectives

Upon completion the student will, in relation to the topics listed below, be able to:

- Analyze the client's financial status and overall estate planning objectives
- Identify the steps in the estate planning process
- Explain the advantages and disadvantages of different estate planning strategies and contrast them with one another
- Conduct the six-step financial planning process and decide on the critical components of the client's plans and objectives
- Assess the tax implications
- Assess the family law/succession law implications
- Assess estate creation initiatives
- Assess estate conservation initiatives
- Assess retirement and disability considerations

- Assess liquidity issues
- Design a financial and estate plan to address the client's objectives
- Recommend strategies for pursuing the financial and estate plan
- Designing the plan to fit the client and avoid common pitfalls
- Describe how unexpected events might disrupt the estate plan
- Explain how the estate plan fits into the client’s overall family and financial situation
- Determine whether or not the client (including spouse, child, parent or beneficiary) is a U.S. citizen.

Topics Covered

Process

- Discovery
- Analysis of information
- Identifying objectives
- Obligations
- Identifying strategies
- Choosing/deciding strategies
- Distribution schemes
- Implementation and follow up
- The advisor team
- Overcoming resistance and procrastination

Designing the Estate Plan to Fit the Client – Avoiding Pitfalls

- Putting the whole plan together
- Client communication
- *Inter vivos* planning/gifting
- Common drafting problems in Wills

Required Textbook Reading

Estate Planning with Life Insurance

Glenn R. Stephens, LL.B.

Chapter 1 – The Role of the Insurance Professional in the Estate Planning Process

Wealth Planning Strategies for Canadians

Christine Van Cauwenberghe, B.Comm. (Hons), LL.B., CFP, TEP

Chapter 1 – Introduction

Introduction

Mastering the planning process is the key to success for all advisors in the financial and personal planning sectors. Engaging the client in an effective planning process draws on the advisor's particular expertise as well as interpersonal skills. The value of having a process that is followed as a regular part of one's practice cannot be over-emphasized. A good advisor brings his or her own professional expertise to the process, whether in the field of financial planning, law, accounting, insurance or other specialty. But whatever the particular professional skill or role in the process, the advisor who works in the estate planning field must also be one-part detective, one-part financial analyst, and one-part psychologist. Estate planning is unique in that it encompasses all the client's affairs and requires an understanding of the client's motives, personality, values, family, and financial and business affairs. In other planning areas, the client may be able to "compartmentalize" the information communicated and isolate one advisor from the other. This is not the case in estate planning.

Estate planning has been likened to a medical diagnosis and treatment. While estate planning is not a disease (though clients sometimes avoid it as if it were), the analogy is a good one. A medical history and symptoms must be gathered (disclosure). Medical tests may be carried out (analysis and issue identification), a diagnosis will be made, and treatment discussed (identifying strategies and recommendations), and treatment administered and recovery monitored (implementation and follow up).

Clients sometimes resist disclosure. It can be time consuming to find all the documents and information required and not all clients are willing to share so much personal information about their wealth and their family situation. It may be appropriate to use the medical analogy. “If you were sick and went to the doctor, all your medical history and symptoms would be needed to treat you. In the same way, I need a lot of information to properly assist you and develop an estate plan best suited to you and your circumstances.” Full disclosure is needed to do effective estate planning just as it is to treat a medical condition and restore a patient to health.

This study unit is not intended to review the substantive law relating to estate planning. Its purpose is to provide a framework within which the expertise may be applied to a particular client’s situation, so that an estate plan appropriate for the client’s situation and objectives can be designed and implemented. The most skilled experts would do their clients a great disservice, and expose themselves to potential liability, if any plan, no matter how simple or sophisticated were implemented without engaging in the process discussed in this unit. The process ensures the plan fits the client’s needs and circumstances. Estate planning is like a custom-made suit – one-size-fits-all will not work. Even if the client ends up with an “off the rack” Will based on a precedent document without any major variations, the process is essential to determine if this is what is appropriate. Without completing the estate planning process, the client may be no better off than drafting his or her own Will from an Internet form or a Will kit. The process ensures that appropriate advice and expertise shape the plan to fit the client.

Benefits of Following the Estate Planning Process

The estate planning process reaps many benefits for the advisor, the client, and his or her family. The benefits include those outlined below.

- **Risk Management:** Errors that may result from poor communication, undisclosed information, or inaccurate information can be minimized with an effective planning process.
- **The Right Plan for the Client:** The planning process avoids the “one-size-fits-all” approach to planning and ensures that the plan suits the client’s situation, needs and objectives, and is consistent with the client’s values.
- **Opportunity Optimization:** Planning opportunities that are not readily apparent can be uncovered during the course of a thorough process that is investigative rather than close-ended.
- **Grateful Clients and Repeat Business:** One of the best ways to build business is through referrals by satisfied clients. A good estate planning process will give clients confidence in the service they have received and provide opportunity for the advisor to ask for and receive referrals.
- **Ensure Capacity:** The process permits the advisor an opportunity to test the client’s decision-making capacity and his or her ability to make decisions free from undue influence.
- **Accountability:** A record is provided through the process for future scrutiny if the Will or any aspect of the plan is later challenged.
- **Details Available:** Following the process provides information that may be critical in the administration of the estate.

Identifying the Steps in the Estate Planning Process

While the labeling and categorization of the steps in the process, and the order in which they take place may vary slightly from one discipline to another, and indeed from one advisor to another, the following is a fair example of the steps in the process.

1. Disclosure and verification
2. Identifying Objectives
3. Analysis
4. Identifying strategies
5. Evaluating strategies and making recommendations
6. Deciding on the plan and taking instructions
7. Implementation
8. Review and follow up

An examination of these steps reveals immediately that the planning process is a collaboration between the advisor and the client. In many cases more than one advisor or professional will be involved, and more than one person within the client's family circle may participate in identifying objectives and assisting in the decision-making process, providing always of course that the client makes his or her own decisions free from undue influence. The role of the advisor is not to simply mechanically gather and record information and produce legal documents that parrot the client's stated objectives without further inquiry or dialogue. It is in the dialogue between the advisor and the client that the process takes life and the real issues can emerge. The advisor's skill and expertise can then be employed to guide the client to identify the real issues, and then design the appropriate strategies.

Particular Requirements for Each Professional

It should be noted that the profession the advisor practices may have its own standards regarding the process. FP Canada has particular prescribed planning steps and practices for financial planners. In the investment field, there are strict "know your client rules" to which licensed investment advisors must adhere. Lawyers are also subject to special rules when engaging in estate planning, including special requirements for joint retainers, and obligations to probe for capacity and take steps to prevent or detect undue influence or fraud. Legislation has now been introduced in Canada relating to money laundering and anti-terrorism. These new laws impose requirements relating to client identification, and reporting of certain cash or suspicious financial transactions. It is expected that each student will be fully aware of his or her own particular professional requirements in addition to information in this study guide and the required reading.

The Importance of Disclosure

Disclosure has several aspects including hard facts and more subjective information relating to the client, often referred to as "soft" information. Details of "hard" and "soft" information are discussed in some detail in the Stephens text and are included in the terminology section of this study unit.

The factual information, sometimes called "hard" information, includes the list below.

- **Assets:** This covers information about the client's property, and all the details of such property including tax attributes (i.e., cost, date of acquisition, etc.), value, ownership, beneficiary designations, and the like.

- **Personal Information about the Client:** These details include place of residence, marital status, date of birth, and citizenship to name some obvious details.
- **Relationships:** This refers to information about the client's family situation. This involves identifying the client's immediate family members, and dependants along with the more extended family tree. This information will be key when the client is considering the obligations under family and dependant's relief law, possible beneficiaries, possible executors and attorneys under powers of attorney, and possible persons who may be the beneficiaries of a common disaster clause in the event the primary beneficiaries all die before the client, or before the funds in any testamentary trusts created in the Will are fully distributed.
- **Legal Arrangements:** Any legal arrangements that the client has entered into should also be the subject of disclosure. These would include domestic contracts, trust arrangements, shareholder agreements, partnership agreements and previous estate planning arrangements such as estate freezes or alter ego or joint partner trusts.

The soft information relates more to the client's personal views and values. While these can be described as factual, they also will influence the part of the process where objectives are identified and decisions are made concerning the choice of beneficiaries, and which strategies are to be utilized to achieve particular objectives. For example:

- Does the client support charitable organizations or causes and is this a priority in the estate plan?
- Does the client have any strong objections or concerns about a particular family member that might affect the benefit that person receives from the estate?

- Does the client have a strong desire to minimize and defer taxes even though this may make the estate plan more complex or more costly?
- Does the client wish to control or protect the transfer of wealth that passes to beneficiaries, or is there a desire to divide and distribute immediately, leaving beneficiaries completely free to use the inheritance how and when they decide without any protection from themselves or third parties?

Errors may result from failure to obtain all the information and ensure its accuracy. These may include:

- failure to obtain accurate information about how property is held (legal title),
- failure to get all the relevant information because a thorough checklist or other systematic fact finding process is not followed, and
- failure to uncover a client's true wishes or hidden agenda that would shape the objectives and recommendations.

A married or common-law couple may confuse ownership of property as between themselves. Or it may be assumed that an asset is held personally, when in fact it may be held by a corporation, a trust, or other person or entity. These are common mistakes that clients make themselves as they may not appreciate the importance of legal ownership for the purposes of estate planning. The role of the advisor, however, is to ensure that the plan is consistent with the client's holdings. If property is the subject of a specific gift, but it is held jointly with a right of survivorship, or there is a beneficiary designation, any gift of such property in the Will fails. Similarly, if an asset is held by a corporation or trust rather than by the testator personally, the gift in the Will fails and the solicitor, or other advisor could be at risk vis à vis a disappointed beneficiary.

The degree to which a client's information is "audited" by the advisor is always a judgment call by the advisor. The client is often not fully aware of all the details of title for personal holdings. Other advisors such as the client's accountant, business advisor, business partner, spouse, or other family member may be better aware of the particulars. Financial statements, tax returns, any existing Will and Powers of Attorney, account statements, and insurance policies may all be reviewed to assist in completing and verifying the information. The advisor must consider how reliable the information given is, and the consequences that may result if the information is incomplete or inaccurate. Some examples are listed below.

- **Specific Gifts:** If an asset is the subject of a specific gift and is significant to the overall estate plan, the advisor would be advised to verify the ownership by checking the account statement documents or title in the case of real property and the value of the property as well as the tax attributes.
- **Title to Real Property:** This may be particularly important as title may be held in the sole name of the client, or in joint names either with or without a right of survivorship.
- **Beneficiary Designations:** Verification of beneficiary designations may also be appropriate as failure to account for this may disrupt the plan of distribution.
- **Forms and Checklists:** Where forms and checklists are used, they should always be reviewed with the client who may easily have omitted important information that can be disclosed in the course of an interview. It never hurts to ask – several times even – is there anything else (referring to beneficiaries, assets, priorities etc.)?

- **Hidden Agenda:** If the client is anxious to have the process completed quickly there may be an undisclosed issue such as terminal illness or other hidden agenda. If the urgency is real, an astute advisor may pick up on this and be able to respond appropriately by either expediting the process, or finding another advisor who can complete the work immediately. If the client dies before the plan is fully implemented the advisor could face a claim for negligence by a disappointed beneficiary.
- **Other Hidden Agenda:** There may be other emotional "hidden agenda" items such as concern over difficult beneficiaries that the client is reluctant to reveal. These may be picked up where the client is inconsistent regarding objectives, asks vague questions, or requests certain planning strategies without providing an appropriate rationale. It may be important to permit the client to share concerns in confidence so the advisor may provide solutions. There may be an issue regarding the stability of the marriage of the client or that of one of the children. A child with an addiction problem or in circumstances embarrassing or shameful to the parent may be difficult for the parent to discuss. Such circumstances should be uncovered tactfully where possible so the appropriate remedial recommendations can be offered to the client for consideration.

It may not be sufficient in all cases for the advisor to hide behind an exculpatory clause in a report that says "all information on which your plan/Will has been prepared is provided by you and not verified by us." This does not mean that such a clause is not to be utilized, but the "fine print" should not be a substitute for making reasonable inquiries. The advisor must always rely to a great extent on information provided by the client, and the client should understand the importance of reviewing the information that is provided and checking it for accuracy. Where forms and checklists are used to gather information, it may be a reasonable practice to have the client “sign off” on these documents once they are completed.

Using Checklists and Forms

Checklists and information forms can be very helpful to ensure all the relevant information is gathered. They are not a crutch for the novice. Rather, they are a tool that ensures important questions are not left unasked and that the plan is executed competently. They can prevent mistakes, and provide protection for the advisor in the event of a future dispute about what information was disclosed. Most estate planners use some form of fact finding form or checklist both for client information and to ensure documents are complete.

Even where checklists and forms are not used, a protocol should be in place to keep a record of the information gathered and the discussions with the client.

Examine the “Estate Planning Factfinder Personal Data” in the Stephens text. While this form is designed particularly for insurance, it is representative of the type of form a lawyer or financial planner might use. Many such forms are available on websites of estate planning lawyers and financial institutions. The forms vary according to the purpose of the form, and the area of expertise of the professional.

Checklists or forms for lawyers preparing Wills and Powers of Attorney should also contain sections relating to the client’s ability to give instructions (i.e., capacity), and undue influence. See for example, the checklists that are on the website of the Law Society of B.C. The form for “testator interview” collects information organized under the following categories:

- Information about the testator's family,
- Information about the testator's estate,
- Testamentary capacity,
- Fraud, undue influence, suspicious circumstances,
- Testamentary wishes, and
- Attestation clause (where special note is made of the formalities and language that must be used where testator's ability to sign a Will is compromised due to factors such as blindness or inability to speak English or French, as the case may be).

Additional information that should be verified and on the form or checklist for Will preparation that might otherwise be overlooked may include:

- Are any of the proposed executors non-residents of Canada?
- Are any of the beneficiaries non-residents of Canada?
- Is the client or any family member a U.S. citizen or a U.S. Green Card holder?
- Are there any step-children or children born out of wedlock in the family?
- Has the client any children from a previous relationship?
- Are there any obligations arising from a separation agreement or marriage contract?
- Are there any personal articles or other assets that the client wants to be left to a particular beneficiary?
- Are there any beneficiaries who receive, or may be entitled to receive, provincial disability benefits?
- Are there any concerns with respect to any beneficiary's ability to manage the inheritance?

- Are any of the assets of the client subject to a contractual obligation that would restrict gifting such as a right of first refusal or a buy/sell agreement?
- Is the client likely to come into a large inheritance in the future that would significantly affect the size of the estate?

Even if such questions are not on a form or checklist, these questions are ones that should come up in the course of the interview with the client. Appropriate use of forms and checklists combined with a probing client interview will improve the quality of advice that the client receives. These may also protect the advisor if in future he or she is accused of failing to identify a particular fact or relevant issue. The records in the file, including the advisor's notes of the interview and the checklist and any form completed by the client, may help determine whether the issue was disclosed or addressed. Thus the advisor may be protected from potential liability where the error arose from the client's own failure to provide complete and accurate information. The notes may also assist in administering the estate by identifying assets or clarifying the testator's intention.

Relationship between Analysis and Identifying Objectives

Once all the information – both "hard" and "soft" – is gathered, the advisor must analyze the information and have a dialogue with the client regarding objectives. Much of the disclosure process can be done in advance of meeting with the client, if a form or checklist is sent to the client in advance and returned to the advisor. However, analysis and identifying objectives should be done with the client in a face-to-face interview. The first interview with the client is critical to the success of the process and the quality of the plan.

It is at this stage that any discrepancies or gaps in information can be identified and remedied. In addition, it is possible at this stage to identify what property the client may have control over by Will, and what property will pass outside the estate. This distinction is extremely important and is often overlooked by advisors. Property passing outside the estate is not subject to the distribution set out in the Will and will include:

- property for which a beneficiary designation may be made,
- jointly held accounts or real property with a right of survivorship (unless there is a special arrangement whereby it is intended such property be administered as part of the estate by the surviving joint owner),
- property already held in a trust such as an alter ego or joint partner trust, and
- property held through a corporation owned by the client.

If there are registered assets such as RRSPs, RRIFs or TFSAs, these can pass to a named beneficiary or a contingent beneficiary under a beneficiary designation. If there is no designation, the plan proceeds will fall into the estate. The tax consequences of these plans must also be accounted for in determining the value of the estate and assets to be distributed to beneficiaries from all sources.

The examination of all information will assist in determining how or whether a client’s stated objectives are obtainable or desirable. For example, the client may state specific goals, but the size of the estate may not warrant such an objective. Setting up a charitable foundation for example, is only worthwhile if a certain threshold of assets is available to fund it. Short of such funding, the cost may be prohibitive and other charitable giving options, such as a self-directed gift to a community foundation might be recommended as a more practical alternative. On the other hand, the client may want something very simple and for the estate to be immediately distributable on death, whereas the tax planning opportunities or circumstances of certain beneficiaries cry out for the recommendation of a trust.

Uncovering Motives and Identifying Objectives

Clients will often state their objectives in the form of a solution or strategy, rather than in terms of a planning objective. A statement that “I want a spousal trust” looks like an objective. However, the advisor will recognize that this is a strategy not an objective. Probing is required to uncover the objective. What is the purpose of the spousal trust? Is it to preserve capital or is the client making the statement because he or she has heard of someone else who has one and assumes that the same strategy provides benefits to everyone, regardless of their personal circumstances? Once the true objective is identified, the advisor can identify the appropriate planning solution which may or may not be a spousal trust (or whatever strategy the client has proposed).

Another common statement is the desire to disinherit a child or other beneficiary. Probing by the advisor can uncover the reason. For example, if the individual cannot manage money, it may be appropriate to recommend a spendthrift trust rather than no inheritance at all. Or, instead of the particular beneficiary receiving the inheritance, perhaps the client may want to consider skipping a generation and leaving what would be that beneficiary’s share (in the case of a child) to that person’s children, or spouse or other family member.

The advisor may uncover the fact that the client has a grudge against a particular family member that may be the product of influence by another beneficiary who stands to profit from the client's decision. An inquiry then might be appropriate to determine whether the decision to "cut out" a person from the Will is truly the client's wish or whether there is undue influence that has so "poisoned" the client's mind that the decision is not voluntary.

The analysis of family and financial information should include an examination of the following issues:

- the tax implications, including identifying problems and planning opportunities;
- the rights of a spouse and other family members arising on death under family law and dependant's relief legislation;
- insurance needs to provide for dependants, provide liquidity, achieve "estate equalization" among beneficiaries, and pay taxes and other expenses of the estate; and
- in some cases, it may be appropriate to include retirement and disability considerations if these have not been addressed already.

Professional Advisors and the Team Approach

Many disciplines and advisors may participate in the estate planning process. The client should be encouraged to permit the various advisors to share information and co-operate with each other in a non-competitive environment. There are two objectives with the team approach. On the one hand, the client should not pay for duplicated efforts, but on the other there should be no "gaps" in the process where issues or details are omitted because each advisor expects the other has addressed them. It is helpful if at least one advisor takes the lead in the process and is responsible for making sure these pitfalls are avoided. That lead advisor can be the primary person who works directly with the client in reviewing the recommendations and assisting the client to make decisions.

In some cases, particularly where there is a family business, the client may have a “trusted advisor” to whom the client will turn for advice. It may be an accountant, business partner or family member. That special person may not have estate planning expertise, but must be part of the team to help the client make or confirm decisions. The trusted advisor may also be key in assisting the other advisors as he or she often has invaluable information about the client’s preferences, philosophy, personal life, or financial affairs.

When working with a team of advisors it is also important to keep in mind that there is no monopoly on good ideas, and often not all advisors have the same information or perspective. As noted in the Stephens text, it is important not to make assumptions about another advisor’s expertise.

Estate Distribution

The way in which an estate is distributed varies with each individual. The bulk of wealth may pass outside the estate if there has been aggressive probate fee planning. Within the Will the client may decide to distribute specific assets by way of specific gifts to individual beneficiaries. This can make the Will challenging to draft as difficult decisions may need to be made as to how the specific property is to be dealt with if the primary beneficiary dies before the testator, or the specific property is no longer owned at the time of death. One common method of distribution is to use a residual clause with division of the estate into equal parts, with each beneficiary to receive a certain number of such parts. If the beneficiary dies before the testator, the parts created for that particular beneficiary are extinguished so that each of the equal parts remaining to be distributed to other beneficiaries have a greater value. This technique reduces the need for excessive “gift over” provisions in the Will and makes it easier for the lawyer to draft (thereby reducing the likelihood of errors) and easier for the testator to understand. A hotchpot clause can be added to reduce the distribution to any particular beneficiary to take into account the value of specific gifts or property passing outside the estate, where appropriate.

One method of testing an estate plan is to demonstrate how property will pass inside and outside the estate to all the client’s beneficiaries after payment of debts, funeral costs, executors’ fees, probate fees or taxes, income taxes, and other costs of liquidating and administering the estate. Estimating the cost of dying and ensuring sufficient liquidity is available to pay all expenses and specific legacies is part of the process. However, charting it out and showing each beneficiary’s actual inheritance can greatly assist the client visualize the final result. In some cases the result may not be what was intended and adjustments may need to be made to the Will, beneficiary designations, or title to assets. Using a hotchpot clause in a Will can provide a method for adjusting a particular beneficiary’s inheritance based on a formula that uses the values of assets at the time of death.

Occasionally the client will ask the advisor how the estate should be divided and distributed among family members and other potential beneficiaries. The advisor can provide guidance but should be careful to support the client’s own decision-making process and not substitute his or her own opinion where the client is uncertain. This can often be done by suggesting several alternative approaches and discussing the consequences of each, providing the client with a framework within which an informed choice may be made.

What If's

An estate plan must be tested by running through all the future or unexpected events that could take place without any assumptions. Such unanticipated events may include:

- an "out of order death," such as when a beneficiary dies before the testator, or before any trust has been fully distributed;
- the value of the estate collapses or increases significantly due to inheritance or windfall;
- the testator no longer owns property that is the subject of a specific gift;
- the testator dies immediately or only after an extended period;
- the marital status of family members changes; or
- new family members are born.

It is always possible to change a Will if the testator is still competent, and a review of the plan should be completed every 3 to 5 years or where the client's personal situation changes. However, the plan should anticipate some degree of change and unanticipated events and make appropriate alternate dispositions to the extent possible. A client may not review or change the Will, or may become incapable. If there is a common accident and one family member dies, and the client is injured and unable to make changes, the existing Will must stand on its own.

Common Pitfalls and Drafting Errors in Preparing Wills

A review of insurance claims against solicitors for errors and omissions in estate planning reveals that one of the most common sources of problems is poor communication between the client and the advisor. There is no limit on the potential source of mistakes, which is one reason the estate planning process is so important. The following factors, whether made by solicitors or other advisors, can result in serious errors or omissions and may also result in liability.

- Failure to identify all the relevant information and verify accuracy.
- Failure to provide for all the reasonable “what if’s” as mentioned above.
- Failure to identify the client’s true objectives by probing stated objectives and wishes.
- Failure to co-ordinate or account for property passing inside and outside the estate.
- Failure to properly identify the tax liabilities and tax planning opportunities.
- Failure to make sure the plan fits the client and the client understands all the consequences.
- Failure to ensure the client has made good choices regarding the choice of executors, including their ability to manage the administration, gain the confidence of the beneficiaries, and co-operate with each other.
- Failure to provide the client with a final report that summarizes the plan and provides a final opportunity for both the advisor and the

client to identify errors, problems or any misunderstanding regarding the plan.

- Failure to adequately identify property that is the subject of a specific bequest.
- Failure to check the title of property that is the subject of a specific bequest to ensure it passes to the beneficiary as intended.
- Failure to check beneficiary designations.
- Failure to properly identify a beneficiary in a Will or beneficiary designation (with multiple family members or charities more than one may have the same or similar names).
- Confusing "children" or another class of persons with "issue," such as an error making a gift to "my children in equal shares *per stirpes*" instead of "my issue in equal shares *per stirpes.*" A Will that distributes to "children" on a *per stirpes* basis is incorrect – a *per stirpes* distribution can only be made to "issue."
- Confusing "per capita" and "per stirpes" distributions.
- Failure to be clear about whether a particular gift lapses if the beneficiary dies first, or from preventing provincial "anti-lapse" rules from inadvertently resulting in an inappropriate gift over.
- Failure to prevent "trust busting" in certain provinces where there must be a "gift over" in order to defer distribution beyond the age of majority.
- Failure to provide against the rule against perpetuities and the rule against accumulations (applicable in some provinces).
- Failure to ensure the formal requirements for legal documents are present. This includes proper signing and witnessing in accordance with the formalities under provincial law; and

- Ensuring that witnesses are not disqualified persons, such as a spouse or beneficiary.

Summary of Key Issues

The Process

Estate planning is a process that has a number of essential steps including discovery, analysis, determining objectives, recommendations, implementation, and review. Following the steps in the process ensures that the plan fits the client and reduces errors that may subject the advisor to liability.

Tools

Checklists and forms can be a helpful tool in guiding the client through the process. Whether they are used or not, the advisor should have his or her own protocol that is followed consistently to be certain that essential information and questions are addressed in the course of the process, and so that no potential problem or issue has escaped scrutiny. For example, is the client or any beneficiary a U.S. citizen? Is there any family member or beneficiary who may need assistance managing an inheritance?

Disclosure

Being disciplined about disclosure is essential to estate planning and clients must understand the importance of providing complete and accurate information. Shortcuts at the disclosure stage can expose the advisor to liability if the plan turns out not to be appropriate because of information that was not communicated or subjected to verification. An astute advisor will be able to ferret out latent issues that the client may be reluctant to disclose but that may be very relevant to the estate planning objectives.

The Advisors

In the course of the estate planning process, issues will be identified by both the client and the advisor, and the expertise from a number of disciplines may be required. The assistance of appraisers, lawyers, accountants, financial planners, insurance agents, trust company personnel, investment advisors, and legal and tax advisors from other jurisdictions may be required. No one advisor can have all this expertise. Knowing when to include other professionals and co-ordinate their input is an important skill.

What If's

A good plan anticipates future events, both anticipated and unexpected. The plan should be tested against the inevitability of change, and modified to ensure it will achieve the client's objectives in all circumstances that can reasonably be anticipated.

Follow Up and Review

No plan is so good it never needs review. Changes may take place over time, or suddenly without warning. A client's family situation, wealth and objectives are never static. Changes in the law can also affect an estate plan. In addition with the passage of time, the persons who might be appropriate executors often change. Clients should be advised that their plan should be reviewed at least every 3 to 5 years or when there is a significant change in their circumstances.

Terminology

Hard facts: Facts relating to a client's personal and financial affairs that are objective and can be verified with documentation or third parties. A client's date of birth or the value of the cottage property are hard facts.

Hotchpot: An adjustment clause, usually in a Will, that requires the inclusion of the value of other property from outside the estate to be added into the calculation for the purpose of determining the share of a particular beneficiary. For example, if the estate is worth $180,000 and is to be divided equally among three children, the share of each child would be $60,000. But suppose one child has already received insurance proceeds outside the estate of $30,000? A hotchpot clause in the Will requires the insurance to be brought into hotchpot in respect of that child's share and will result in that child receiving only $40,000 from the estate and the other children receiving $70,000 each. This has the effect of equalizing each child's benefit arising on death since each child will have received a total of $70,000, whether from inside or outside the estate passing under the Will.

Per capita: A distribution that is equal per person no matter what the relationship to the deceased.

Soft facts: Information relating to a client's views, judgments, wants, and philosophy that are subjective to the client. The fact that a client is concerned about the potential claim of a difficult son-in-law, for example, is a "soft fact." Soft facts often influence a client's objectives.

Review Questions and Answers

Questions

1. List four benefits of the estate planning process.
2. Joseph likes to meet with his clients "cold" without requesting his clients provide any information or do any preparation in advance of the initial meeting to discuss estate planning. He believes this permits him to see the bigger picture at the initial meeting without getting bogged down in details about assets and specific information regarding family members. Discuss the advantages and disadvantages of such an approach. What are the advantages of having disclosure at the initial meeting?
3. Which of the following are hard facts:
   a. Title to the property inherited from the client's parents was left to all the children.
   b. The client's charitable intentions.
   c. The number of grandchildren the client thinks are worthy of special mention in his Will.
   d. The adjusted cost base of shares of a private company.
   e. The client's concern about her husband's ability to make sound investment decisions.

4. Peter and Paul are married, same-sex partners with one adopted child. They want their estates to go to each other initially, and then to their adopted daughter Tracey, age 21. If Tracey has died, they want their estate to pass to Tracey's children, if any. Peter, who is 62 and a successful professional, has assets worth approximately $4.2 million. Paul, who is 44, is a golf professional with assets worth approximately $335,000. These figures do not include their home, which is jointly held, or their registered plans or insurance for which they have named each other as beneficiaries. What additional information do you need to advise them regarding their estate plan?

5. Assume you are a lawyer or other advisor to Jennifer and Brian, a married couple in their early 50s with two children in university. They are about to live out their lifelong dream of sailing around the world. They are leaving in 10 days to fly to the Caribbean where they will join a group that has chartered a sailing vessel for a round the world adventure. They have rented their home for the next year and taken leaves of absence from their jobs, and used part of an inheritance from Jennifer's aunt to finance their expenses. They have never done Wills or Powers of Attorney before, despite your past advice that these be done. Today is Thursday and Jennifer has just called you requesting that you arrange to have "simple his and hers" Wills and Powers of Attorney prepared for them based on your knowledge of their personal and financial affairs. They can "drop by your office" on the way downtown to pick up their new passports and would like you to have the documents ready next Tuesday for signature. Comment on this situation in the light of the estate planning process and make recommendations as to how to proceed.

Answers

1. There are many benefits to the estate planning process. You should be able to elaborate on the details of the benefits, explaining how the process results in the benefits. For the purposes of this question, which just asks for a list, you could include:
    a. ensures the plan fits the client;
    b. helps uncover issues and opportunities the client may not have been aware of;
    c. helps prevents errors;
    d. helps ensure the client is properly insured;
    e. protects the advisor against liability; or
    f. provides an opportunity to evaluate the client's capacity.
2. Joseph's approach has the following disadvantages:
    a. The information needed will still have to be gathered. If gathered at the initial meeting this may result in a tedious discussion over details. If gathered after the meeting, the "big picture" discussed at the initial meeting may need to be significantly revised. This may make Joseph's job more difficult, as he may have to re-explain the planning strategies appropriate, and clients may become confused or uncertain with respect to his advice. In addition he may have spent some time covering areas that turn out not to be appropriate, possibly increasing the cost to the client.
    b. Another meeting may be required to take instructions at which the client's information is reviewed and verified. Having the client provide the details later without review can lead to errors or omissions.

c. The client can state the objectives at an initial meeting, but objectives must always be analyzed in the light of the client's particular circumstances so the advisor's ability to comment is limited.

d. Planning opportunities can only be identified in a general way without complete information.

The advantage of Joseph's approach is that it may help overcome client procrastination or reluctance to commence the estate planning process. It is often difficult to motivate clients to do estate planning, and requiring the production of detailed information can be a barrier to overcoming the natural inertia to the process. Having an "introductory" meeting without disclosure may help clients understand what is involved in the process and help motivate them to provide the information required. It may also be appropriate if there is an urgent situation such as where a client has a sudden medical emergency, or is terminally ill. The advisor can probe for capacity at the outset, and determine if it is even possible to take instructions. Disclosure can follow the initial meeting where necessary, but advisors should be extremely cautious if there is urgency – the temptation to "skip full disclosure" because of the circumstances can lead to errors and potential liability. In addition, if the advisor is not able to act immediately, it is better to let another advisor do the estate planning as delay could also result in liability if the client dies before completion.

There are advantages of having detailed disclosure at the initial meeting.

a. A review of the information gathered at the initial meeting can be done relatively expeditiously with experience. The advisor can verify details with the client, and creating a "shopping list" of missing information for the client to provide later.

b. The advisor can make a good assessment of the client's objectives.

c. The advisor will be able to identify issues and planning strategies that fit the client's situation.

d. Specific planning opportunities can be identified at the initial meeting.

3. a and d are hard facts.

4. Additional information that may be particularly relevant may include that listed below.

a. Are there any other family members that need to be provided for? For example, have either Peter or Paul had previous partners or children from other relationships?

b. Are they married or common law? This is necessary to determine what property regime applies to them under provincial law and the degree of testamentary freedom.

c. If Tracey has died, at what age should her children receive their inheritance?

d. How do they want their estates distributed in the event of a common disaster – i.e., none of Peter, Paul, Tracey or her issue survive?

e. Paul is 18 years older than Peter. Does Peter want to give everything to Paul outright, or does he want to ensure capital protection for Tracey and her issue in the event Peter enters into another relationship and changes his estate plan, or becomes obligated legally to another partner?

f. What debts do they have? We are only given values of assets not the net value of their estates.

g. If something happens to either Peter or Paul, will the survivor have enough to pay debts, and continue his or her lifestyle? (It seems quite likely given the numbers – but if assets are matched with debt, insurance needs can be identified.)

h. What is the value of their home? Is it subject to a matrimonial property regime? Is it held jointly as tenants in common or with a right of survivorship?

i. What is their intention with respect to the home?

j. What is the value of the registered plans and insurance?

k. What is their philosophy regarding planning – do they want to “keep it simple” or are they interested in investigating complex planning strategies?

5. The estate planning process requires time that these circumstances do not permit. The advisor should consider carefully whether to get involved at all, given the time pressure and the margin for error. If the advisor knows the clients well, and has up-to-date financial and personal information it may be possible to advance the process far enough before they leave, but this is always a judgment call. Lawyers will generally not prepare Wills or Powers of Attorney without meeting with the client to take instructions. In rare circumstances where this is not possible, the lawyer will have an obligation to meet with the clients before the documents are signed to confirm the instructions, and test for capacity and absence of undue influence and fraud. For example, in this situation, you have only spoken with Jennifer – what are Brian’s instructions? These must be verified and any requirements regarding joint retainers for making

Wills complied with. If the disclosure can be brought up-to-date, it may be possible to arrange a meeting with a lawyer before they leave. Any outstanding items can be checked by another friend or family member, after the initial meeting. It is unlikely that all the steps can be concluded in such a short time. There needs to be a face-to-face meeting with the lawyer preparing the documents. Disclosure needs to be completed as fully as possible. The documents must be prepared, and the clients should review the drafts so that changes can be made if required. With modern communication, it may be possible to take instructions before they leave, and have draft documents sent by email, fax, or other means. Final documents might be emailed with instructions regarding due execution, or even sent by mail, to a lawyer in another jurisdiction on their itinerary, or directly to the client. If simple “his and hers” Wills and Powers of Attorney are really all they need, it may be possible to complete the documents before they leave. However, caution is necessary. Haste always involves risk of overlooking something and making mistakes. Even with simple “his and hers” documents, Jennifer and Brian must still choose their executors and determine how their children will receive the inheritance.

Unit Two: Personal Estate Planning

Knowledge Objectives

Upon completion of this unit the student will:

- Understand the role of tax and estate planning in preserving and transferring wealth
- Understand post-mortem tax planning strategies and when they are appropriate
- Understand complex tax issues and traps applicable to trusts and estates
- Know how to plan for incapacity and death
- Understand the tax and legal consequences of death
- Understand how provincial succession laws can impact estate plans
- Understand the rules relating to charitable giving
- Know how trusts are utilized to achieve non-tax objectives
- Understand how trusts are used in tax planning

Skills Objectives

Upon completion the student will, in relation to the topics listed below, be able to:

Will Planning

- Assess the role of a Will as critical to true estate planning, whether one views that planning as being aimed at the fulfillment of the deceased's desires relating to estate distribution or as tax minimization
- Explain the benefits of engaging a qualified lawyer to develop a reliable Will
- Compare the advantages and disadvantages of various choices for executor and explain the alternatives to the client
- Assess the client's estate liquidity and explain the issues around an estate that does and does not have liquid assets

Estate Tax Planning

- Formulate appropriate estate planning strategies to mitigate the effect of the tax implications at death
- Identify post-mortem tax planning opportunities
- Describe the strategies for post-mortem planning with closely held corporations, including reducing the double tax on property held in a corporation
- Analyze the client's assets and ownership interests and determine those properties that will and will not be subject to probate
- Explain how rollovers and the capital gains exemption can be used to advantage

Planning with Trusts

- Analyze the client's current financial status and financial planning objectives with a view to determining a planning strategy involving the use of trusts
- Examine alternative types of trusts that may apply to support the client's estate planning strategies
- Illustrate to the client the benefits of the use of trusts in estate planning
- Know how trusts are utilized to achieve non-tax objectives
- Understand how trusts are used in tax planning
- Understand complex tax issues and traps applicable to trusts and estates
- Describe the ways trusts can be used to preserve wealth and provide protection
- Identify how trusts can be used to achieve non-tax objectives
- Take into account advanced tax issues and traps for trusts and estates
- Explain the potential problems arising from the attribution rules and the 21-year rule
- Identify key tax problems often encountered with trusts and estates

Charitable Giving

- Identify the client's charitable giving objectives and discuss alternatives for planned giving during life and at death
- Understand the rules relating to charitable giving

- Identify how charitable giving can be incorporated effectively into an estate plan

Planning for Incapacity

- Identify the need for planning for incapacity
- Describe how Powers of Attorney are used in the event of incapacity
- Identify the criteria for choosing a substitute decision maker
- Compare the advantages and disadvantages of selecting particular substitute decision makers and explain the alternatives to the client
- Assess the client's Powers of Attorney and health care directives
- Understand some of the obligations of attorneys

Probate Planning

- Examine alternative strategies for the efficient and secure transfer of assets inside and outside the Will at death
- Show the client alternative strategies and assist him/her in selecting the most appropriate strategy for his/her situation

Required Textbook Reading

Most of the information you will need in order to answer the questions related to personal estate planning will be found in the required textbook reading. These materials are simply to provide some context for the textbooks and should not be seen as a substitute. For the Wealth Planning for Canadians text, some chapters include a section called "Jurisdiction Differences". Where that occurs, you should read only the section related to the jurisdiction in which you practice. In the event you are required to reference material that varies from jurisdiction to jurisdiction, you should identify which province or territory you are referencing when providing an answer. Multiple choice questions will not involve answers that vary between the jurisdictions.

Estate Planning with Life Insurance

Glenn R. Stephens, LL.B.

Chapter 7 – What to Look for in Shareholder Agreements and Wills

Chapter 9 – Charitable Giving Strategies Using Life Insurance

Chapter 10 – Life Insurance and Trusts

Chapter 11 – Creditor Protection

Wealth Planning Strategies for Canadians

Christine Van Cauwenberghe, B.Comm. (Hons), LL.B., CFP, TEP

Chapter 18 – Powers of Attorney

Chapter 19 – Distribution of an Estate

Chapter 20 – Personal Representatives

Chapter 21 – Taxation at Death

Chapter 22 – Probate

Chapter 23 – Trusts

Chapter 24 – Charitable Giving

Introduction

Preserving wealth and implementing an effective plan for wealth transfer are at the heart of personal estate planning.

It is expected that each student will already have some professional experience and educational background in the subject matter listed in the topics for this study unit. The assigned reading material is intended in large part to serve as a review of topics of which the student should already have knowledge and understanding. The purpose of this study unit, and indeed the ones that follow, is to assist the student to pull together broad areas of information and be able to apply them together in an integrated fashion to real life client situations. Some of the details will be left to the particular professions. The lawyer will know the rules in the province that are required to be followed in order for a Will or Power of Attorney to be legally binding. The accountant will know the deadline for filing estate tax returns and making income tax payments. The financial planner will be able to project spending, estimate tax liability, determine funding requirements, and investment returns during retirement to predict estate value. Trust officers will be intimately familiar with the details of estate administration and managing assets of an incapable person, and the duties and obligations of attorneys, trustees and executors. These are all aspects of estate planning, but not a complete picture. This course is intended to provide an overall perspective of all aspects of estate planning so that each professional understands the context within which his or her work is performed.

Will Planning

It is critical that advisors be able to explain the need for an up-to-date Will prepared by a lawyer who has the appropriate expertise for the client's particular needs. The fallout from poor planning and an inadequate Will does not usually occur until the testator (or intestate) is incapable or dead. Individuals who have had a family member pass away without a good estate plan, or no Will at all, are often anxious to ensure their own estate plan is well prepared because they have lived through the problems that can occur. Consequences of poor planning or no planning include inappropriate distribution, emotional strife, family conflict, litigation, family law claims, dependants' relief claims, delays, additional costs, wasting of assets while no person has authority to manage the assets of the estate or family members cannot agree, inadequate provision for spouse and dependants, problems with minor beneficiaries, additional income tax liability, etc. These are discussed in detail in the Wealth Planning text.

Often individuals will procrastinate about preparing Wills and Powers of Attorney until there is a perceived need or crisis. The following factors can be good motivators:

- illness,
- surgery,
- travel,
- death of a loved one or sudden death of an acquaintance,
- birth in the family,
- marriage, particularly second marriage,
- urging of spouse, or
- world events, such as 9/11 or the COVID-19 pandemic.

The cost of doing a Will is a barrier for many individuals who may only have used a lawyer when they purchased a home and not otherwise. However, if one compares the cost of making a Will with the annual cost of the insurance policy on one's home and car, the one-time fee for preparing a Will to ensure that the entire wealth accumulated during a lifetime is properly transferred without the provincial and federal government maximizing their share may be seen from a better perspective. Most lawyers will prepare Wills. However, not all lawyers have the expertise that may be required for particular situations. Tax planning, trust planning, planning for owner-managers, problem beneficiaries, conflicts of interest, and history of family dissention may all call for a lawyer whose practice includes estate planning as a main or significant component.

Choice of Executor/Personal Representative

The choice of executor or personal representative is often not given sufficient thought. The appointment of the surviving spouse and then all the children follows the way most individuals distribute their property on death. However, some probing may reveal weaknesses in this strategy. The following questions might be asked.

- Who should administer the estate if the surviving spouse is 80 or older?
- Do the children always get along?
- Do the children speak to each other and all live in Canada?
- Is there one child who tends to take control and is resented by the other children?
- Are there one or more children whom the others all respect?
- Do the terms of the Will provide for ongoing trusts where discretion is to be exercised? If so, how will the personal representatives

exercise that discretion – is there any concern that the children may not agree, or if some are left out, that they may resent the position of the other?

- Will the persons chosen outlive the termination of any trusts?

An impartial person is often a wise choice if there is potential conflict, acting alone or along with other family members. When death occurs in a family, particularly on the death of the last parent, children and their life partners are often very emotionally fragile and life-long resentments that were repressed for the benefit of "keeping the peace for mom and dad" often rise to the surface and spark anger and conflict. Unfortunately, parents often over-estimate the degree to which their children will co-operate as co-executors. The appointment of a personal representative who will not enter into this arena of conflict can go a long way to an efficient administration and avoid litigation. Naming three persons and permitting a majority decision can help break deadlocks, and if one person tends to be the most respected or reasonable, the testator can require that person to be a member of the majority. Wills also can name a person to whom the executors can turn for advice or assistance in making decisions, although the personal representatives are still responsible for making decisions themselves.

It is important for testators to understand the consequences of the administration of the estate being hijacked by warring personal representatives. In general, the courts will not come to the assistance of personal representatives who cannot make their own decisions. While it is possible to ask the court for direction, the courts will not remove an executor for failure to agree on a decision (assuming no wrong doing is present) nor will the court substitute its decision for one that the personal representatives have been given the authority to make in the

Will. This in effect forces the personal representatives to work together and can cause further resentments and conflict.

Estate Distribution

Distribution of an estate from the Will takes place through general gifts, specific gifts, and through the residual clause. General gifts are gifts of cash. Specific gifts are gifts of specifically identified property. Once all debts of the deceased and of the estate are paid, and a tax clearance certificate obtained, the remaining property of the estate is available for distribution, and is referred to as a residual gift.

If there is insufficient property to pay all debts, the gifts in the Will must be reduced, and this reduction is called “abatement.” The residue is exhausted first. Then general gifts abate first (after the residue), then specific gifts of personal property (moveable property), then specific gifts of real property.

Where property that is subject to a specific gift in the Will is no longer owned by the testator on death, it is said to “adeem” and the beneficiary will not receive anything in respect of that gift.

For this reason, testators should be careful when disposing of a large portion of their estate through general and specific gifts as some beneficiaries may be inadvertently short-changed, either through abatement or ademption. In addition, because the value of particular assets can fluctuate, the value of any particular beneficiary’s inheritance is unpredictable, and the testator’s intentions may be frustrated. Using the residual clause to dispose of the bulk of the estate is often more appropriate as the property of the testator can be divided into the appropriate portions for each beneficiary from a common pool of assets.

Where the beneficiary of a gift in a Will dies before the testator, the gift is said to "lapse" and the property will fall into the residue of the estate to be disposed of under the residual clause. If the gift subject to lapse is in the residual clause, there will be an intestacy with respect to that property. A gift will not lapse if there a contrary intention expressed in the Will, such as an alternate gift or gift over of the property to another beneficiary. Use of the words "if she survives me" indicates that the gift will lapse if the individual dies before the testator assuming there is not also a further gift such as, "but if she does not survive me to X, if he survives me" in which case the gift would only lapse if both beneficiaries die before the testator. Most provinces have anti-lapse legislation whereby if a gift to a deceased family member is made in a Will, and the gift would otherwise lapse, there is a statutory gift over to another family member. For example, a gift "to my son Tom," may pass under anti-lapse legislation to Tom's children if Tom pre-deceases the testator.

In preparing a Will it is always important to provide for contingencies. What if the personal representative dies or moves away and cannot act? What if a child dies first? What if the estate increases or decreases significantly in value? What if children get divorced? What if the property gifted to a particular beneficiary is sold? While it is always possible to change a Will to fit new circumstances, a good Will anticipates many contingent events so that the Will still provides an appropriate result in the event the Will is not revised, or the testator is no longer capable to make a Will.

Taxation at Death

The desire to minimize taxes on death is often a motivator for estate planning. While the consequences of dying without a Will can result in higher taxes, tax planning should not be the only motivator. However, many people avoid the topic of death because it makes them feel uncomfortable and, for these individuals, fear of taxes may be a last resort to overcome the procrastination that often accompanies estate planning.

On death there is a deemed disposition at fair market value of all capital property and all inventory, and the funds in all RRSPs and RRIFs are fully taxable. The income and capital gains triggered by death are taxed in the terminal return, the tax return of the deceased for the year of death from January 1 to the day of death. The balloon income in the year of death may result in a higher tax bill, and may also result in more income being taxed at the higher or top marginal rates. There are a number of exceptions to the tax on death:

- the principal residence exemption,
- the spousal rollover for capital property transferred to a spouse or "qualifying spouse trust,"
- the capital gains exemption for shares of a small business corporation,
- the capital gains exemption for qualifying farm property,
- the capital gains exemption for qualified fishing property (including licenses),
- the inter-generational rollover of active business farm property,
- the spousal rollover for RRSPs and RRIFs, and

- other restricted rollovers for RRSPs and RRIFs to a financially dependent minor child, financially dependent disabled adult, and a trust for a mentally disabled child or spouse.

One of the most important tax planning objectives is to ensure that the tax liability on death does not interfere with the plan of distribution to beneficiaries. Will there be sufficient assets in the estate to pay the taxes and also pass specific assets to beneficiaries? The family vacation property and family business are common examples of assets that the client may intend to pass on to the next generation, but which may need to be sold in order to pay the tax liability.

Since only one principal residence exemption is available to a married couple (for years after 1981), the family vacation property is often taxable on death of the surviving spouse. If the property has increased significantly in value, and this is often the case where the property has been held for many years, and may have even been passed down from a previous generation, then the high value of the property only increases the tax bill with no additional cash in the estate to pay it. If the assets of the estate are not sufficient to pay the taxes, insurance may be an option.

With a family business, there may be tax relief if the shares qualify for the capital gains exemption. This is a cumulative lifetime exemption available to individuals only. With good planning, business owners can often double up on the use of the exemption with a spouse.

In addition to the above exemptions, there are a number of elections and special tax rules that can further reduce the impact of taxation on death.

- Capital losses, including unused capital loss carry forwards from previous years, are deductible against any source of income in the year of death, and can be carried back to the year before death to offset any source of income in that year.

- Capital losses in the first taxation year of the estate can be carried back to the terminal return and used to offset any source of income in that year (but there is no further carry back to the prior year).
- Unused RRSP contribution room can be used to make a tax-deductible contribution to a spousal plan if made within 60 days of the year of death and can be deducted from the terminal return.
- A separate return is available for income that qualifies as “rights and things” (such as declared but unpaid dividends).
- A separate tax return is available for “stub period” income from a business where the tax year end is not December 31 and the taxpayer dies after the tax year end in the calendar year.

None of charitable donation credits, non-refundable personal credits, capital losses, non-capital losses, or the capital gains exemption of the deceased flow through to the estate or any beneficiary. It is therefore tax efficient to use them fully if possible in the returns of the deceased. The personal representatives can elect out of some of the rollovers available to generate additional income to absorb losses, deductions, or credits, including the deduction available on property eligible for the capital gains deduction. In addition, if there was little or no income in the year of death, triggering income to be taxed at the lower marginal rates may be appropriate.

The benefit of electing out of a rollover on capital property is that the cost base to the beneficiary will be increased from the estate’s cost to the fair market value, thereby sheltering additional capital gains when the property is sold by the spouse. In the case of the spousal rollover on capital property, the election is on a property-by-property basis for proceeds of disposition at fair market value. It is an “all or nothing” choice. For registered plans, however, a rollover may be made on any portion of the refund of premiums. The benefit of electing out of the rollover for registered plans is that the spouse can receive the funds outside the plan and no further tax will be payable. For the intergenerational rollover for farm property, a range of amounts between tax cost and fair market value is available.

If the deceased leaves their assets to a qualifying spousal trust, assets that are transferred to the trust within 36 months will be eligible for a rollover. If minimizing capital gains on death is an objective, assets with the highest unrealized capital gain might be used to fund the trust. On the other hand, if there are unutilized capital losses or non-capital losses available in the terminal return, the assets with the higher gain might be sold to satisfy other gifts, or if transferred to the trust, an election made out of the rollover for those properties. The value of assets with an unrealized gain transferred to a spousal trust on a rollover basis should be discounted in value. For example, if the Will provides that one-half of the residue is to be contributed to a spousal trust and the other half to a family trust, the assets should not necessarily be divided based on fair market value alone. The unrealised latent tax liability on the assets transferred to the spouse trust should be considered.

During the administration of the estate decisions will have to be made regarding which assets are used to pay debts, satisfy general gifts and other gifts in the Will, and which assets will be used to fund any testamentary trusts. The selection will depend on the purpose of the trust, the terms of the Will, and the tax consequences.

It is important for personal representatives to understand the importance of seeking tax advice. And such advice should not be confined to preparing the terminal return and the estate return. As can be seen from the many exemptions and strategies discussed above and in the materials, there are many opportunities that a tax advisor can uncover to save tax for the estate and the beneficiaries. Often if there is a surviving spouse no tax planning is done. All property is allowed to rollover to the spouse, including capital property and registered plans. This is not always the most effective plan if the deceased had unused capital loss carry forwards or unused capital gains exemption available or other shelter available in the returns of the deceased.

Planning with Trusts

Trusts are an important component of estate planning. Their origin is linked to English history and many of the rules relating to the creation of trusts, the duties of trustees, and the remedies for abuses are also derived from the common law or “judge made law.” Trusts are not like corporations, which are legal entities. A trust is a relationship whereby property is transferred by way of gift (called a “settlement”) by a settlor (the deceased in the case of an estate), to a person (called a “trustee,” or in the event of death an “executor,” “Estate Trustee” (in Ontario), “liquidator,” or “personal representative”). In order for a true trust to be created, three certainties must exist – certainty of intention to create a trust, certainty of subjects (i.e., the property settled on the trust), and certainty of objects (i.e., the beneficiaries must be identified or capable of being identified by non-ambiguous objective criteria).

If the seemingly arbitrary rules relating to the creation and ongoing operation of a trust are disregarded, there may be serious consequences. If one or more of the three certainties are absent, the tax consequences of all transactions will be determined as if there were no trust. In addition, the arbitrary use of a trust to facilitate particular results in the midst of a commercial transaction should be approached with caution. The use of a trust in such situations is very different from other entities, such as corporations, which are often interposed into commercial transactions for strictly tax or other purposes with impunity. Trusts are more fragile and the CRA may challenge the existence of the trust if only the tax consequences are intended and not a trust relationship.

Trusts are used for many different purposes, but in essence there are two main purposes: protection of assets or tax planning. Trusts separate the control and legal title of property from the beneficiary. This provides protection for any number of purposes.

- To protect property from the beneficiary's own behavior.
- To protect property from claims against the beneficiary, such as those of a creditor or spouse.
- To protect the interest of remainder or residual beneficiaries after a life interest.
- To provide financial management and security for a beneficiary with special needs.
- To provide for succession of property where the beneficiary is incapable of making a Will.
- To provide unified management of a particular property for use by multiple beneficiaries.
- To preserve or manage a particular asset until arrangements can be made to sell or develop a succession plan (such as a business).

The tax planning benefits of trusts are not necessarily incompatible with using trusts for protection. Often the two are combined. The primary use of trusts for tax purposes is to income split. With *inter vivos* trusts, an understanding of the attribution rules is essential to design trusts for tax purposes and tax advice is essential in setting up, funding, and managing such trusts. While the focus of this course is estate planning, it is also expected that students will have a solid grasp of the attribution rules and other issues relating to *inter vivos* trusts from their other studies and professional experience. Life insurance can be very effective in trust planning as the tax-deferred growth in a life insurance policy is not subject to the attribution rules, and, since a life insurance policy is not capital property, it is not subject to the 21-year rule.

The use of trusts for protection and tax planning is well developed in the materials in the case studies.

In general, trusts are taxed as individuals and as such are entitled to the dividend tax credit available to individuals. In addition, trusts are a conduit for tax purposes. To the extent that income is paid or payable to a beneficiary, that income will be taxed in the hands of the beneficiary and deductible to the trust. In addition, sources of income and their tax attributes can flow through to a beneficiary. Capital gains, including those eligible for the capital gains deduction, taxable dividends, capital dividends, and foreign source income, are all examples of income that retains its character in the hands of a beneficiary (although this is not always the case if the beneficiary is a non-resident of Canada).

Where testamentary trusts are included in the Will, steps must be taken during the client's lifetime to ensure they are funded. This may include changing title of jointly held assets into individual ownership and changing beneficiary designations to ensure property passes through the estate. The loss of creditor protection and increase in probate fees need to be factored into the cost benefit analysis.

Charitable Giving

Working with clients to identify and implement philanthropic objectives requires an understanding of what motivates people to make donations to charitable causes. The tax benefits may be attractive, but there must be a true desire to benefit the charity as the tax benefits cover only a portion of the cost. When taking Will instructions, the client may not be thinking about donations, but often will decide to include donations when this topic is explored with the advisor. Here are some questions to help identify charitable intent and uncover tax motivated giving:

- Are there any causes you support or would like to support?
- Do you support your church, synagogue, place of worship, etc.?
- In your annual income tax returns, do you claim any charitable donation credits?
- Would you like to make one last gift as a parting legacy to the charities you've supported during your lifetime?
- Are you aware of the tax benefits of charitable giving?
- Are you aware of the special tax benefits of donating publicly traded shares with unrealized capital gains to charity?
- Are you interested in learning how insurance can be used to fund charitable giving without significantly reducing your family's inheritance?

Clients may have a desire to make donations subject to conditions. This can cause problems. The condition may not be enforceable for any number of reasons. For example, the condition may be void for uncertainty, or contrary to public policy. The condition may not be consistent with the charity's objectives or may no longer be appropriate at the time of death. A gift to the church to "replace the roof" may not be appropriate if this has already been replaced when the testator dies. The advisor will need to work with the client to ensure not only that the client's objectives can be implemented, but that the charity will also accept the gift. Contact the charity directly to design the terms of a gift to suit the charity and the donor.

Consider the benefit of community foundations where the client has specific charitable purposes, but the creation of a charitable foundation is not feasible because the gift is modest, or the client has no desire to bear the cost or the administrative burden of operating a charity. For example, a $40,000 gift for scholarships to needy students who are recent immigrants to Canada could be made to a community foundation in the memory of the testator. Community foundations permit “donor directed” gifts, and the testator can name a person who would assist the community foundation to select the recipients of the funds. A number of Canadian financial institutions also offer donor advised funds.

The wrong name of the charity in the Will or trust is often the subject of litigation or a failed gift. The Canadian Association of Gift Planners (“CAGP”) publishes the *Canadian Donor’s Guide,* which lists many of the Canadian registered charities. It is published annually and distributed to all lawyers in Canada who are members of the Wills, Estates and Trust section of the provincial chapter of the Canadian Bar Association. It can also be purchased directly and viewed on the CAGP website. Canada Revenue Agency (CRA) also lists all registered Canadian charities on its website. If the organization is not on this list, a donation tax credit will not be available. The ability to make donations to non-Canadian charities is subject to specific tax rules, and the use of the donation tax credit is available only to offset tax on income from the foreign jurisdiction where the charity is located.

There are a number of ways charitable donations can be structured. The appropriate strategy will depend on many factors, including the donor’s particular intentions or wishes, the donor’s assets, the tax treatment, the size of the gift, the requirement for flexibility during lifetime, and whether the donor is insurable. The two course texts discuss these strategies in some detail along with the benefits and tax consequences of each, which include the following:

- direct donation of cash to a charity,
- donation of property in kind,
- donation of an insurance policy,
- naming a charity as a beneficiary of a life insurance policy,
- naming a charity as the beneficiary of an RRSP or RRIF,
- donating to a charitable remainder trust,
- donating to a private or public charitable foundation,
- donating to a donor advised fund, and
- structuring a donation through an annuity, insured or otherwise.

The tax treatment of a donation of capital property in kind, or *in specie,* results in a deemed disposition at fair market value for tax purposes. If there is an unrealized gain, the donation will result in a capital gain, 50% of which must be included in the donor's income, subject to a "zero" inclusion rate for publicly traded securities and certain other very specific types of property, such as ecologically sensitive land. Insurance policies are not capital property and the treatment of their donation is discussed in the course texts.

Planning for Incapacity

Canadians are living longer, and the number of seniors who are unable to make decisions for themselves is greater than ever. The law relating to substitute decision making, including Powers of Attorney and guardianship is becoming very important in modern day practice. Unfortunately, the estates of incapable persons are often the subject of litigation, usually where attorneys or guardians have not carried out their responsibilities with diligence and honesty. Mismanagement by an attorney is often not discovered until the donor dies, and by that time considerable loss may have occurred and it may be too late to enforce any remedies against the attorney. Good planning can assist to some extent, although choosing an attorney who has the right qualities may go a long way to avoiding abuses. Not only must the attorney be honest and a good money manager, he or she must be willing and able to carry out their responsibilities diligently and continuously.

The law relating to substitute decision making for personal and health care varies considerably by province. If there is a Power of Attorney for personal care or a health care directive in place, most jurisdictions in Canada require the attorney (or whatever the name for such person is in the particular province) to consent to medical treatment if the patient is unable to provide such consent.

Probate Fee Planning

Probate fees are quite low in Alberta, Nunavut, Northwest Territories, Quebec and the Yukon. In these jurisdictions, probate fees are truly “fees” in that the modest cost of obtaining the grant of probate reflects the service provided. However, in the other provinces higher rates of probate fees apply, such that in legal terms the fees are actually a tax. For example, in Ontario the cost of probate is called the Estate Administration Tax. The difference between a fee and a tax became key when the Supreme Court of Canada in *Eurig* confirmed that the Ontario probate “fees” were unconstitutional because they were a tax not a fee, and as such had to be imposed by statute not by regulation. While the *Eurig* estate escaped the tax, the Ontario government was permitted to retroactively amend the legislation to protect its right to collect the tax.

For convenience, the term "probate fee" will be used generically here except where the context dictates otherwise. In jurisdictions where probate fees are really a tax, probate fee planning may be relevant to reduce the cost of obtaining the grant. However, probate fees are only above 1% in BC, Ontario and Nova Scotia, so even in the "high" rate provinces the amount is still very low, particularly in comparison to things like income tax rates. Probate fee planning should never be done in isolation, as failure to understand the potential consequences of steps taken to reduce the cost of probate can result in disaster. The problems are numerous, but generally fall into two categories – failure to distribute the assets of the deceased among beneficiaries in the way that was intended, and increased income tax liability or missed income tax planning opportunities. In addition, many lawsuits have resulted from using joint accounts were there is uncertainty as to the intention of the deceased. Like all estate planning, the assistance of a professional is advised, and no estate planning strategies should be implemented without reviewing the overall plan to make sure there is consistency.

Unfortunately probate fee planning is an area where clients often willfully engage in destructive self-help. The strategies to reduce probate fees often have a significant impact on the distribution of wealth on death.

For example:

- If a large portion of the assets of the deceased are passing outside the estate to avoid probate, it can be difficult, and sometimes impossible to achieve estate equalization through the Will even with good planning. The use of a hotchpot clause in a Will is sometimes used to provide for an adjustment to the share of a beneficiary to account for property passing outside the estate. However, there must be sufficient assets in the estate to fund the adjustment.

- There is no gift over for assets passing outside the Will. A “gift over” is a provision that provides for an alternate beneficiary in the event the primary beneficiary has died first. Limited gifts over, or “contingent beneficiaries,” can be made in beneficiary designations for insurance or registered plans, but financial institutions will accept only the most simple gifts over. It is not possible to provide for a gift over for jointly held property. Complex gift over provisions are standard in any professionally prepared Will. The most common gifts over are to the children of the deceased if the spouse has died first, and to the grandchildren of any child who has pre- deceased the testator. One less problematic approach may be to use a “multiple will” for assets that can be transferred without a grant of probate (e.g. shares of a privately held corporation). The courts in Ontario and British Columbia have confirmed the validity of this strategy. The availability of this strategy in other provinces is uncertain and as yet untested by the courts, and depends on the particular language of the statute that imposes the fee, although it is clear that they cannot be used in Nova Scotia.

Another potential probate strategy may be to create an alter ego or joint partner trusts. Although the instances in which these types of trusts may be limited, they can be useful in certain situations.

Summary of Key Issues

Every adult should have a Will, and Powers of Attorney for property and personal care or health care to ensure that their personal and financial affairs are managed responsibly and in accordance with their wishes in the event of incapacity and/or death.

Choosing a substitute decision maker for financial management of property is an important decision that should be made after taking into account all the duties and responsibilities and ensuring that the person or persons selected are honest and will act diligently. While honesty and good financial management skills are essential for acting as an attorney for property, these are not essential for an attorney for personal care. The latter should be available to be contacted and make decisions in an emergency situation and should be willing to carry out the donor's wishes relating to end-of-life care and extraordinary measures.

Choosing an executor wisely is important to effective estate administration. The executors should have the same qualities as an attorney for property, and, in addition, they should be able to work together, if there is more than one. Additionally, they must act fairly and impartially and be able to gain the trust and respect of the beneficiaries.

Charitable giving can be integrated into the estate plan to accomplish charitable objectives and take advantage of tax benefits, such as the donation tax credit and reduced inclusion rate for donation of some property in kind. The benefits of using insurance to fund donations and the capital dividend account should be considered where appropriate.

Probate fee planning can reduce the cost of probate fees on death, but it should be done as part of estate planning as a whole. The savings achieved must be analyzed in light of the cost of implementing probate fee planning, the additional complexity it may introduce to the client's financial affairs, and other planning opportunities that might reap greater benefits.

There are many tax planning strategies that can reduce or defer the tax cost of dying. After death, many options and elections are available to reduce the tax in the final return and make the transfer of wealth to beneficiaries more tax efficient. Special strategies are available where the deceased held an interest in a private corporation. Tax planning strategies, i.e., income splitting or income sprinkling, are available in some cases through testamentary trusts and these can reduce the overall tax burden on income from an inheritance.

There are many non-tax uses of trusts. These include protecting beneficiaries from themselves or others, protecting particular property for use by multiple or for future beneficiaries, and preserving capital for a beneficiary after an intervening life interest. Often the tax benefits of trusts can be combined with the non-tax objectives. The two are not necessarily mutually exclusive.

Review Questions and Answers

Questions

1. Name two properties that can be gifted in kind to charity that will result in a 0% inclusion rate on unrealized capital gains on the property.
2. Identify the tax consequences, and other benefits and drawbacks of designating a charity as the irrevocable beneficiary of a life insurance policy as opposed to designating it as the revocable beneficiary.
3. Explain the benefits of a charitable insured annuity.
4. What exceptions exist to the creditor protection provided to life insurance proceeds on death?
5. What strategies are available to prevent an attorney for property from acting improperly, or neglecting their duties and preventing loss to the estate of the incapable person? Explain why these strategies are effective.
6. List the differences between a Power of Attorney for property, and a Power of Attorney for personal care or a health care directive.
7. What are the advantages of obtaining the grant of probate? What are the advantages of not being required to obtain the grant of probate?
8. Mabel is an elderly widow who has three nephews who do not get along. She wants to leave her house to Steve, her RRIF to Colin, and the balance of her estate to her favourite nephew, Garth. She had a Will made 10 years ago giving Garth 50% (two equal shares) of her estate and Steve and Colin 25% (one equal share) each. On the advice of her brother, Mable put the house in joint names with Steve, and named Colin as the beneficiary of the RRIF, and changed her Will to make Garth the sole beneficiary of her estate under her Will. Since

the house is worth roughly 25% of her assets, and the RRIF worth another 25% at present, Mabel and her brother think this is a good plan to save probate fees. What problems do you see with this plan? What would you recommend Mabel do?

9. What are the consequences of dying without a Will? Assume there is a surviving spouse, and two surviving children, ages 21 and 15. Assume the assets consist of an non-registered investment account worth $670,000 with $220,000 in unrealized capital gains, and a family cottage that is not eligible for the principal residence exemption (as that was used on another residence) worth $145,000 with $50,000 in capital gains. You do not need to be specific regarding the provincial formula.

10. Jennifer dies leaving her estate to her issue in equal shares per stirpes. She is survived by two of five children, Faith and Bess. Of the three deceased children, Hope is survived by three children, Charity is survived by one child (but she had another child, Lee, who died but is survived by one child), and Albert is survived only by his spouse, Irene. Jennifer's estate is worth $1,200,000 after all expenses and debts. How will it be distributed?

11. What is the benefit of filing separate tax returns in the year of death?

12. List four ways the income in the terminal return might be maximized. Why might the accountant preparing the terminal tax return decide to increase the income (including capital gains) in the year of death?

13. In what circumstances might the principal residence exemption not be claimed in the year of death? Why should it always be claimed if available, assuming there is a gain on the property?

Answers

1. Publicly traded shares, and ecologically sensitive land.

2. Listed below are the tax consequences and benefits and drawbacks of donating an insurance policy to charity, or designating a charity as the beneficiary of a life insurance policy:

   a. If a newly purchased policy is assigned irrevocably to the charity, the premium payments will be eligible for a donation tax credit. The benefit is that the donor of the policy gets an immediate donation credit during their lifetime. The disadvantage is that there is no donation credit on death, and the donor has no control over the policy (i.e., the donor cannot change the beneficiary to another charity or other person).

   b. Where the charity is named as the revocable beneficiary, the life insured who is the owner of the policy will be entitled to a donation tax credit in the terminal return, as the donation is deemed to be made before death. The advantage is that the timing of the donation tax credit matches the tax liability on death and naming a charity as a direct beneficiary protects the proceeds from creditors and probate fees. The donor can change the beneficiary if his or her intentions change in the future.

3. A charitable insured annuity provides a charitable donation tax credit matched with a life insurance policy to replace the capital used to purchase the annuity. It achieves charitable objectives without reducing the value of the estate to be distributed to beneficiaries.

4. Life insurance proceeds are not protected from creditors where:

   a. the funds were transferred to the policy for the purpose of evading creditors;

   b. Proceeds are payable to the estate, or

   c. In some provinces, where there is a claim under dependants' relief legislation.

5. There are a number of strategies to ensure an attorney acts honestly and responsibly and no loss is suffered.

   a. Choose the attorney wisely. If the person does not have a proven track record for being trustworthy, good with money, and conscientious, another person should be considered.

   b. Appoint more than one attorney and require them to act together (rather than severally). It is less likely that two or more persons will conspire together to act improperly, and each attorney can be the "watchdog" for the actions of the other. In addition, sometimes a team of attorneys who are required to work together can ensure that all the qualities required to manage the financial affairs of the donor are present. One person may be an excellent money manager for example, and another may have the time and expertise to ensure proper accounts and records are maintained.

   c. Name a person to whom your attorney must account on a regular basis. While any interested person can request a formal passing of accounts, an informal requirement in the document is less onerous and expensive and this may be a good way to monitor the attorney's actions before abuses or neglect get out of hand and the value of the person's estate is seriously affected.

d. Name a trust company as the attorney or co-attorney. Trust companies have policies and procedures in place to ensure responsible money management. Although individual employees could act improperly, the trust company would be obliged to rectify any problem and would have the funds to pay damages or repay any amounts misappropriated. An individual attorney could squander funds, and even if ordered to pay them back, the funds may not be recovered.

e. Once the person is incapable, family members or other interested persons may be able to prevent loss to the estate by asking for accounts to be prepared by the attorney. If they are not produced, a formal request may be made to the court, which may order passing of accounts.

6. The differences between a Power of Attorney (POA) for property and a Power of Attorney (POA) for personal care or a health care directive may include:

a. When it is effective: A POA for property may be effective immediately during capacity of the donor and may or may not be effective during incapacity depending on whether it is a continuing POA for property (or a mandate in respect of incapacity in Quebec). A POA for personal care is only effective if the donor is incapable.

b. What type of decisions may be made: A POA for property relates only to financial decisions (i.e., the management of property owned by the donor). A POA for personal care relates to decisions relating to the physical body and physical and social environment of the donor.

c. Consequences if no POA is made: If there is no POA for property, the public trustee will generally have authority over the assets of the incapable person and it will be necessary for any other person to apply to the court for a formal appointment as guardian of the person's financial affairs. If there is no POA for personal care, provincial legislation provides a ranking of persons who may consent to medical treatment in the absence of a POA for personal care (or health care directive). There is generally no "back up" in provincial legislation for non-medical or non-health care decisions relating to personal care.

7. Advantages of obtaining probate:

a. Third parties, such as financial institutions, land registry offices, and others controlling title to property, will permit a transfer of the property of the deceased into the name of the executor or beneficiary.

b. Claims for property by a spouse under family law and claims for dependants' relief may expire only after probate is filed in some jurisdictions.

c. It protects the executor from liability in the event the Will is subsequently found to be invalid.

d. The application process provides an opportunity for beneficiaries or others to raise objections to the Will or bring forward another Will.

Advantages of not obtaining probate:

a. Savings – Probate fees are avoided.

b. Privacy – The Will is not available for public inspection so the affairs of the deceased and the family may remain private.

c. Savings – Where the value of assets requiring probate is reduced, but the requirement for probate is not completely eliminated, there may also be a reduction in executor's fees and legal fees, depending on whether they are calculated on the value of assets subject to probate.

8. There are a number of problems:

a. Fluctuating Values: While the value of assets may achieve Mabel's goals today, over time the value of these various assets may change significantly. The RRIF has a required minimum payout every year starting in the year Mabel turns 71 and it may be worth much less in the future. The house and the assets passing through the estate may also change in value.

b. Loss of Control: Mabel may want to sell the house in future. For example, it may become too much for her to maintain or she may need to go into a nursing home and selling the house may make good economic sense. If Steve is added as a joint owner, she would have to get Steve's consent to sell the house, and then she will have to change her will if she wants to ensure that Steve is not disinherited. If she is no longer capable when the house needs to be sold, she may not be able to change her Will.

c. Uncertainty regarding joint ownership of the home: A gratuitous transfer to a person other than a spouse or minor child is subject to the presumption of resulting trust. Mabel must document her intention to make the transfer of the home a true gift to Steve. Otherwise it will remain in her estate, be subject to probate fees, and will be inherited by Garth.

d. Loss of Principal Residence Exemption: If two people own a residence, they must both use their principal residence exemption on a sale if the gain is to be fully sheltered. If Steve does not “ordinarily inhabit” the property as his residence, then it will not qualify as his principal residence, and Steve will have to pay tax on any gain that accrues after the transfer of the property on his share. If Steve was Mabel’s child, it would qualify as his principal residence but if Steve has his own residence, he will likely want to use his exemption on his own home.

e. Tax on the RRIF: The tax on the RRIF is paid out of the estate. As Garth is the only beneficiary of the estate, his share will be reduced by the tax on the RRIF paid to Colin. Mabel’s plan ignores the tax liability arising on the RRIF on death that is a liability of the estate.

Mabel could do probate fee planning.

a. Assuming she is 65, she could do an alter ego trust, and leave Colin as the beneficiary of the RRIF. She could include a hotchpot clause in the trust so that on her death an adjustment is made to Colin’s share to ensure he receives his 25%. A cost benefit analysis would have to be done to ensure that the future savings in probate fees is worth the initial legal cost of setting up the trust, transferring property to the trust, and the ongoing costs of preparing annual tax returns and paying any trustee fees.

b. But it may be better if her estate is modest and the cost of an alter ego trust is not warranted, just to do the beneficiary designation on the RRIF and let the house and other assets go through her estate under her Will. A hotchpot clause could be used to equalize Colin's interest. Although this plan still attracts probate fees, Mabel needs to understand that the cost of probate fees is relatively minor and the cost is well worth avoiding the problems listed above that would result in a distribution that is unpredictable, and probably not what she intends.

c. If there will not be enough in the estate to equalize the assets even with a hotpotch clause, then it may be better to have no direct beneficiaries on the RRIF, and a specific distribution in the will.

9. The consequences of dying without a Will include:

a. The estate will be distributed according to the provincial formula. Generally, the surviving spouse will get the preferential share and the children and the surviving spouse will share the balance of the estate. Depending on the province, generally if there is more than one surviving child, the children will share two thirds of the balance with the spouse receiving one third of the amount in excess of the preferential share.

b. Someone must apply to the court to be granted the authority to administer the estate as an "administrator," "liquidator" in Quebec, or "estate trustee without a Will" in Ontario.

c. Delay in managing the estate. A personal representative under a Will has immediate authority. However, in the case of an intestacy no one has authority until the appointment of an administrator is made by the court. In addition, there are additional legal requirements for an intestacy that will delay the administration of the estate. In some jurisdictions there is a time period before assets from an intestate estate can be distributed.

d. Additional costs. Additional legal costs will be incurred on an intestacy. In addition, the administrator may be required to post a bond in order to be granted the appointment.

e. The Public Trustee will have control of the inheritance of the minor child.

f. The minor will receive his or her inheritance upon attaining age 18 or 19 (depending upon the jurisdiction) and the 21-year-old will receive his or her inheritance once the estate is ready for distribution.

g. There will be income tax on death and since the spouse does not inherit the entire estate, it will not be possible to shelter all the capital gains with the spousal rollover. It may be possible to minimize this problem by carefully selecting the individual holdings in the portfolio and transferring those with the greatest gain to the spouse. However, in valuing the assets to be distributed, some discount may have to be given to property transferred with an unrealized capital gain.

h. The Court will have no guidance regarding the appointment of a guardian for the minor child. Usually the court will give weight to the parent's wishes – here they are unknown.

i. Delay in administering investments. The value of the portfolio could suffer if important decisions need to be made before an administrator is appointed.

j. Inflexibility regarding investment policy and administration of the estate. The administrator will be restricted to the authority granted under common law and the statutes in the province. A Will could have permitted greater flexibility regarding investments and broader powers relating to administration.

10. Distribution of Jennifer's estate is as follows:

Faith	$300,000
Bess	$300,000
Each of Hope's 3 children	$100,000
Charity's surviving child	$150,000
Lee's child	$150,000

Explanation: There will be a primary division into four equal shares. No share is created for Albert as he has died without issue. Each surviving child will receive one share, and each surviving grandchild of a deceased child will divide the share of his or her deceased parent. There will be a division of Charity's share into two equal parts for each of her children who either survived her or died with issue surviving, in the same manner as Jennifer's estate was divided into four shares. Lee's child will receive the part of Charity's share created for Lee.

11. More income can be taxed at the lower marginal rates.

12. Income might be maximized in the terminal tax return by electing one of the following options:

    a. Electing out of the spousal rollover on certain properties,

    b. Refraining from electing to deduct income from a RRSP or RRIF that is eligible for a rollover (to spouse, dependent minor child, or dependent disabled adult child) so all or a portion of the refund of premiums is taxed in the terminal return,

    c. Electing out of the inter-generational rollover for family farm property or a family farm corporation or family farm partnership, or

    d. Electing out of a spousal rollover on property qualifying for the capital gains exemption.

    Income might be increased in the year of death by the above means because there may be "shelter" in the terminal return from tax and including these sources of income in the terminal return will save taxes in respect of the particular property in the future. For example, electing out of a rollover of capital property in a, c, or d above will result in the estate or the beneficiary having an increased adjusted cost base (at fair market value except for farm property where the election permits a range) thereby providing future shelter from capital gains. In the case of b, the beneficiary of the registered plan will receive the refund of premiums tax free without being required to contribute them to his or her own plan. Shelter in the terminal return could result from:

    a. Unused capital losses in the year of death or carried forward from previous years that are deductible against all sources of income in the year of death,

b. Unused non-capital losses available in the year of death,

c. Low income in the year of death permitting additional income to be taxed at lower marginal rates,

d. Availability of the capital gains exemption, or

e. Unused charitable donation tax credits or other tax credits.

13. The principal residence exemption might not be claimed if:

a. It was not available because it had been claimed in all previous years. However, because of the plus one in the formula it should be claimed in the year of death on at least one property – subject to c below.

b. It might not be claimed on a particular property (where more than one property owned at death qualifies) since only one principal residence for any particular year of the holding period may be claimed.

c. It may have been claimed for all available years, including the year of death, by a spouse.

The principal residence exemption should always be claimed if available since the property passes to the estate or beneficiary at fair market value whether the exemption is claimed or not. NOTE: also, the one plus in the formula increases the amount sheltered by the exemption even if only claimed for one year.

Unit Three: Family Estate Planning

Knowledge Objectives

Upon completion the student will appreciate how estate plans are tailored to suit different family situations.

Skills Objectives

Upon completion the student will, in relation to the topics listed below, be able to:

- Identify issues and planning strategies that are appropriate to the client's family situation and the property to be distributed to family members
- Assess the client's obligations to a current or former spouse or common-law partner
- Assess the client's obligations to dependants and other family members
- Identify alternative planning strategies to satisfy the client's legal obligations to family members
- Analyze the client's family situation and discuss and evaluate the client's objectives with respect to family members as beneficiaries
- Identify alternative planning and distribution strategies to meet the client's estate planning objectives with respect to family members
- Identify the planning issues for different family situations, such as marital status, with or without children

- Discriminate among alternative planning strategies and recommend preferred alternatives to the client to address family support objectives, obligations, and family distribution objectives
- Explain the potential estate planning problems that arise from blended families
- Identify issues relating to “uneven” distributions to children
- Identify issues and make recommendations with respect to distribution of a recreational property to family members

Required Textbook Readings

Most of the information you will need in order to answer the questions related to family estate planning will be found in the required textbook reading. These materials are simply to provide some context for the textbooks and should not be seen as a substitute. For the Wealth Planning for Canadians text, some chapters include a section called “Jurisdiction Differences”. Where that occurs, you should read only the section related to the jurisdiction in which you practice. In the event you are required to reference material that varies from jurisdiction to jurisdiction, you should identify which province or territory you are referencing when providing an answer. Multiple choice questions will not involve answers that vary between the jurisdictions.

Wealth Planning Strategies for Canadians

Christine Van Cauwenberghe, B.Comm. (Hons), LL.B., CFP, TEP

Chapter 2 – Single

Chapter 3 – Common-Law Couples

Chapter 4 – Engaged

Chapter 5 – Married

Chapter 6 – Separated

Chapter 7 – Divorced

Chapter 8 – Blended Families

Chapter 9 – Widowed

Chapter 10 – Children

Chapter 11 – Grandchildren

Chapter 12 – Disabled Persons

Chapter 13 – Elderly Parents

Chapter 14 – Seniors and Retirees

Chapter 15 – Vacation Properties

Chapter 17 – Family Property

Introduction

Estate planning rarely takes place without significant consideration of the individual’s family situation.

Family members are typically the first choice as beneficiaries and there may be legal obligations to provide for a spouse, partner or dependent child. Everyone has parents, and they may or may not be included in the client’s list of potential beneficiaries. Many people marry or enter into common-law relationships or other conjugal relationships and want to provide for their spouse or partner. If they do not want to provide for a spouse or partner, there may be a legal obligation to provide support or property and the estate plan should address such obligation. Failure to do so may invite estate litigation and disrupt the administration of the estate and the planned scheme of distribution. Children are also important family members in the estate plan, both as potential beneficiaries, and because there may be legal obligations to provide support if they are minors or otherwise dependent on the parent because of a disability.

The nature of the relationship between the client and family members, and the relationship among family members may shape estate planning objectives. The client may not want to include estranged family members in his or her Will or provide the same share to all family members in the same blood relationship to the client. Family members who do not get along may pose problems relating to choice of executor. In addition, the estate plan may need to be designed to minimize conflict, or at least reduce the risk that it will disrupt the administration of the estate.

If the client has particular assets that are to be distributed in kind to family members, such as a business or recreational property, the family tree and family dynamics will be relevant to the estate plan and the distribution scheme.

This study unit will examine estate planning in light of the client's family situation. A sound grasp of the topics covered in Study Unit One: Estate Planning Process and Study Unit Two: Personal Estate Planning is assumed.

There is no pre-determined estate plan that fits a client based solely on family situation. The client's estate planning objectives will be shaped by family situation but will also be a result of the nature of the client's assets, the extent of his or her wealth, values, stage in life, and the particular relationship the client has to his or her family. However, family situation is one of the most significant factors in determining the client's estate planning objectives.

The advisor must be able to uncover the client's family members, identify the "natural objects of affection," and understand how a client's family situation may affect his or her objectives and obligations. The client's objectives, with respect to distributions of property to particular family members, must also be assessed by the advisor with respect to how this might affect other family members. Distributions of property in kind, and unequal distributions to children or their families will raise issues that the advisor must be prepared to identify and discuss with the client.

This study unit provides an opportunity for the advisor to learn to apply his or her technical knowledge to particular family situations and develop an estate plan that meets the client's objectives and legal obligations with respect to family members.

Strategies to achieve family succession objectives and meet legal obligations to family members are discussed in the material. Other objectives, including tax planning, and preserving family harmony (or minimizing conflict), must be woven into the estate plan. The advisor will need to understand all of the client's objectives and be able to identify a number of possible strategies to achieve them.

The ability to identify, discuss, and evaluate alternative estate planning strategies, and make recommendations to assist the client in choosing the appropriate strategies among competing priorities is the essence of estate planning. It requires an understanding of the technical aspects of estate planning, including legal and tax issues. It requires an understanding of the client's family situation and knowledge of the client's estate (i.e., the nature and value of property that will pass on death). And lastly, it requires an understanding of the client's thinking and values that shape the estate planning objectives. These include the client's views or "philosophy" about how wealth should be transferred to and divided among family members, the client's charitable objectives, his or her tolerance for complexity, and the importance of tax minimization.

Ultimately the client will need to choose among competing objectives and strategies with the assistance of the advisor. The advisor should be able to make recommendations by presenting the advantages and disadvantages of the various strategies, how they interact, and how they affect the overall plan, including the distribution to family members. A skilled advisor will be able to prioritize the decision-making process for the client. Identifying the essential objectives will often put other priorities into better perspective. For example, saving taxes may be a priority and the client may be prepared to make a significant charitable donation to reduce taxation on death. However, few clients will want to make a donation so large that the inheritance intended for family members is reduced significantly.

The advisor may provide his or her opinion as to the recommended course of action in light of the client's objectives. However, the advisor must make it clear to the client that it is the client's responsibility to make his or her own decisions.

Choice of Beneficiaries

Family members are typically beneficiaries of the estate, and often the only beneficiaries. The spouse or partner and children are the usual beneficiaries if the client is in a traditional family. In traditional families, a common distribution is to leave everything to any surviving spouse or partner, with a gift over to children in equal shares and a further gift over to issue of a predeceased child in equal shares per stirpes.

Clients often ask about the typical distribution to family members. While it is perfectly appropriate to set out the most common distributions, assumptions should never be made about the client's wishes, nor should the client be given the impression that a particular distribution to family members is the "right" thing to do, or is what family members are entitled to receive.

For example, often clients will want to protect a child's inheritance from any claim that may be made by that child's spouse or partner in the event of a breakdown of the relationship. But this should not be assumed. Is it possible that the client has a concern about the child's ability to manage the inheritance wisely, and wants to ensure that the child's spouse has control over the inheritance or is adequately provided for along with any children of the marriage? The plan for the child's inheritance might be completely different in the latter case.

The above example illustrates how the family tree alone cannot be used to produce a formula for the plan. The full family situation, including the client's concerns and wishes to benefit and protect family members, needs to be examined.

The distribution to family members may also need to be modified in light of other estate planning objectives. It is not unusual for these to be developed during the estate planning process with the assistance of the advisor's input. The advisor's role is to identify potential planning strategies applicable to the client's situation. The client may initially be unaware of the possible uses of trusts in estate planning. For example, the client may learn that a trust can be created to protect an inheritance of a special needs or "black sheep" beneficiary. After consideration of other possible objectives discovered during the estate planning process the "typical" distribution may be altered significantly.

Undue Influence and Protecting the Estate Plan

The advisor must be alert to the potential for undue influence and avoid supporting or implementing an estate plan without taking steps to ensure the client's instructions are given independently. This is true in all situations, but the client may be more vulnerable if elderly, has reduced or diminished cognitive ability, is dependent on others for care or companionship, has few or no family members, or is isolated or estranged from his or her family.

The vulnerability of aging individuals is increasingly becoming a major concern in estate planning and the estate plan should consider possible future problems relating to the diminished capacity or risk of undue influence.

For example, while typically all assets are left to the surviving spouse, the surviving spouse may not ultimately dispose of the assets as the client would have wanted or anticipated. A surviving elderly spouse may become the victim of a predatory marriage. Or children may start to manipulate the surviving parent's emotions and influence them to redistribute wealth in an inappropriate manner.

Two of the most common estate planning mistakes is to assume that the surviving spouse will always "do the right thing" and that children will behave altruistically and in the best interests of each other rather than in their own self-interest. Children often acquire a sense of entitlement over time relating to their parent's estate that may arise from what is perceived as fair, deserved, or earned by caring for the aging parent. This may not be in accord with what was planned when the parents were both alive, healthy and independent. And while it is possible to set aside a Will in the event of undue influence, this is a very onerous requirement for family members, and often the influence exerted on the surviving spouse may fall short of influence that is "undue."

Where the succession of particular assets such as a family business or recreational property are an important component of the estate plan, it may be appropriate to implement a strategy to protect that plan from possible alteration by a surviving spouse or partner. This might also be considered where there is a possibility the surviving spouse may be prone to be influenced to favour one child over the other in the future. This might be a concern, for example, where the following scenarios exist:

- there is a history of sibling rivalry,
- a concern that some children are greedy or manipulative,
- the spouse is inclined to prefer some children over others, or
- the spouse is easily influenced.

Using a spousal trust can be an effective strategy to protect the estate plan.

Unequal Distributions and Disinheriting Children

Children generally expect that they will share equally in their parents' estate. If the distribution among children is not equal, the client should be aware that children may resent the parent or each other, and this may not be the legacy the parent wants to leave. The advisor should inquire into the reasons for unequal distributions. Common reasons relate to the children's respective financial well-being, the child's needs, the parent's approval or disapproval of the child's lifestyle or behaviors, or the relationship between the child and the parent.

For example, perhaps one child has received more financial assistance from the parent already. In some cases, this may result in the parent deciding to leave less to such a child. On the other hand, if the child has more need than the other children the parent may actually want to leave such a child a greater portion of his or her estate. The reason for the financial assistance must be examined. Is one daughter widowed and in poor health with diminished earning capacity and dependent children? Or is one son completely irresponsible with money disregarding his own financial security and that of his wife and children? The strategies to address these situations differ as may the degree to which the other children may be comfortable with the parent's decision as to distribution.

To dissuade disgruntled family members from disputing an estate or making a claim, and prevent a successful challenge to a Will, a number of strategies may be employed. These may include any of the solutions set out below.

- Take steps during the estate planning process to demonstrate or ensure the testator has capacity and is free from undue influence. The solicitor preparing the Will may ask for an assessment. A record of the discussions and questions intended to probe for capacity should be made and retained. Instructions should be given and confirmed without the supervision or presence of beneficiaries or other interested parties.
- If there is a significant alteration in the plan from previous Wills, the reason should be recorded. This may provide support in future to show there was no undue influence. A Will can be set aside if undue influence is proved (on a balance of probabilities) by the challengers. Suspicious circumstances may constitute part of the evidence that suggests undue influence. An unexplained change or one that is not reasonable or rational may be a suspicious circumstance.
- A gift may be made on condition that the gift will fail if they dispute the Will or make any claim against the estate. Note that such conditions may be void and the lawyer preparing the Will must ensure that there is a specific gift over in the event the gift is to fail. In addition, if the Will is successfully challenged, the conditional gift will fail in any event along with the Will. The client should be aware that such a clause cannot prevent a claim that the Will is invalid, or a successful family law claim for division of property or a claim for dependants' relief. However, if the gift is large enough, it may make the beneficiary less likely to litigate. Note also that in Quebec the right to patrimony overrules the Will in any event without making any claim.
- Discuss the distribution with family members so they understand the reasons and have the opportunity to discuss the decision with the parent during his or her lifetime. While this may not prevent conflict,

it will at least eliminate the element of surprise that may otherwise be the “last straw” in converting an unhappy and grieving family member into a litigant. Children may be more likely to respect the parent’s decisions if the parent has been open and honest, and there has been a dialogue where both the parent and the children have had the opportunity to express their own views of what is fair and appropriate.

Children

For dependent children a trust should always be provided to ensure that the public trustee or other public official in the province does not obtain control of the child’s inheritance. This alone is a very good reason for parents to write a Will.

Parents usually do not want their children to receive their entire inheritance when they reach the age of majority. Two questions result: when should children receive their inheritance, and who will manage any funds set aside for them in trust in the meantime?

The timing of distributing an inheritance to children is very personal and varies according to the parent’s philosophy and the children’s particular characteristics. If there is no specific concern, an age for distribution can be chosen with distributions of capital at the discretion of the trustee throughout the duration of the trust. Income is usually discretionary during minority and may continue to be discretionary after minority or automatically payable. Staged capital distributions may be required prior to termination of the trust as well, although this may not be necessary if there is a general power to encroach on capital.

The degree of discretion given to the trustees may depend on the identity of the trustee. For example, to make decisions less onerous for a family member, there may be less discretion, but more generous required distributions. If the trustee is a trust company or there is no concern that beneficiaries may pressure the trustee, broader discretion may be granted.

Summary of Key Issues

For many clients, estate planning is all about their family. Family members will have expectations about what they will receive from a parent or other family member's estate, and in many cases family members will have a legally enforceable claim against the estate if sufficient provision is not made for them. Individuals usually want the bulk of their estate to pass to family members. If the balance between what an individual wants to leave to the family on death, and the family's expectations or rights is not made, litigation may result. Even worse, family relationships may be irreparably harmed, and the legacy of the deceased individual may be one of bitterness rather than fond memories and an orderly passing of wealth.

The relationship between family members is also important if they are required to co-operate in the administration of the estate or if resentments among family that spark disputes are to be avoided. It is also important to examine the relationship of the client to his or her family members to determine his or her objectives and philosophy about transfer of wealth. For example, does the client think it should be as simple as possible and every beneficiary should receive their inheritance as soon as possible? Or is the client determined to extend terms beyond death by creating trusts that control the property and keep it out of the hands of the beneficiary for a period of time after death?

It is rare that an individual has no family members who play a part in the estate plan. Even if the individual wants to disinherit family members completely, this may be subject to some restrictions if there is a potential claim for dependants' relief, division of property under family law or a claim for an equitable remedy.

Terminology

Inter Vivos: During lifetime. Refers often to gifts made during lifetime or trusts created during lifetime as opposed to those on death.

Proponent: the person who is supporting the validity of a position or document. In reference to a Will, it refers to the party seeking to have a Will probated, and who is asking the court to formally approve of the Will.

Quantum Meruit: An equitable remedy that awards compensation for the value of services provided gratuitously.

Review Questions and Answers

Questions

1. Explain why the following statements are true or false:

   a. Married couples who have everything in joint names with a right of survivorship and have designated each other as beneficiaries do not need Wills because everything will pass automatically to the surviving spouse.

   b. The advisor should encourage parents to treat their children equally in their Wills.

   c. In discussing how a client plans to divide and distribute his or her estate in the Will, the advisor should be asking open-ended questions.

   d. Minor children should be provided for in a Will by creating a trust for their inheritance.

   e. Claims for dependants' relief can be the subject of a marriage contract such that the surviving spouse can relinquish his or her right to make a claim against the estate.

   f. Making a minor child the beneficiary of a registered plan is a good strategy as the proceeds need not be taxed in the terminal return, and the proceeds of the plan can be invested in an annuity payable to age 18 and the tax treatment deferred until the annuity payments are made.

   g. Common-law couples are now recognized legally in all provinces in Canada and are accorded the same rights and privileges as married partners.

2. Suggest five family situations that might make the appointment of a trust company (i.e., a "corporate executor") a wise choice.
3. Explain why estate planning is particularly important for common-law couples. What is required to ensure the surviving partner inherits the wealth of the first to die? How might this differ if the partners wish to limit the right to an inheritance? Your answer should address documents required and title to property.
4. How should the terms of a testamentary spouse trust be set in order to:
   a. achieve the spousal rollover, and
   b. achieve maximum potential income tax savings through income splitting for each of the children and their families after the death of the surviving spouse?
5. In what circumstances would it be appropriate to make a dependant's relief claim (or wills variation claim in BC) against an estate? Give at least two examples.
6. Compare the estate planning objectives and issues of a married couple with young children to those of a married couple who are 65 or older with adult children and grandchildren with respect to the following matters:
   a. choice of executor,
   b. support obligations,
   c. concerns about remarriage of surviving partner, and
   d. protection of beneficiaries (other than spouse) against family law claims.

Answers

1. True or False and Explanations.

   a. False. There will be intestacy if both spouses die in a common accident. In addition, certain unanticipated amounts could be payable to the estate (e.g. insurance from an automobile accident claim).

   b. False. The advisor should avoid imposing his or her views on the client and permit the client to consider his or her own wishes. The advisor may advise regarding the consequences of the client's wishes but permit the client to make an informed choice regarding his or her estate.

   c. True. As above. Assumptions should not be made and the discussion with the client should always be designed to encourage the client to explore his or her own wishes. The advisor should never say –"you probably want all your children to inherit your estate." However, if asked by the client, the advisor might say "most parents leave their property to their children in their Wills in equal shares, but you are not required to do so, short of providing for dependants." Open-ended questions are particularly important if the client is prone to be easily influenced by others. If the client does not know how to decide a particular issue, the advisor may suggest options along with advantages and disadvantages to each alternative. If the client cannot decide, the advisor can move on to other issues and allow the client time to make a decision, which might be at a later date after consultation with other family members or persons whom the client looks to for advice (assuming there is no undue influence).

d. True. This will avoid the public guardian or other public official from gaining control of the child's property. In addition, the trust can extend beyond age 18 so distributions are delayed until the child is old enough to be financially responsible.

e. False. It is not possible to contract out of support obligations or dependants' relief.

f. False. There are many problems with minor's being beneficiaries of registered plans, including the requirement to appoint a guardian for property to manage such funds once received.

g. False. Common-law spouses are not recognized at all in some jurisdictions and are only recognized for some purposes in others.

2. Family situations that might make the appointment of a trust company (i.e., a "corporate executor") a wise choice are any of the following:

    a. There is a second marriage and an on-going testamentary trust is created to provide for the second spouse but ensure children from the first marriage benefit after the death of the spouse.

    b. There is a trust for a disabled child for life, requiring a trustee over a long period of time.

    c. No family member, or other suitable individual, is resident within the jurisdiction (if only available persons are non-residents of Canada this is especially important).

    d. Children do not get along.

    e. The testator is single or widowed with no children, or other suitable person to appoint.

    f. The testator is separated but financial settlement relating to property has not yet been reached and it is not desirable to have children handle this as executors.

g. There is a testamentary spousal trust because the other spouse is incapable or has poor financial management skills.

h. Wherever a testamentary “protection” trust is needed (such as a spendthrift trust, creditor protection trust) for a child, and it is not desirable to have the other children be their “brother’s keeper.”

3. The law across Canada varies from one province (or territory) to another and the rights of a surviving partner can be unpredictable. Failure to plan adequately, or at all, can result in litigation if the surviving partner is not adequately provided for, especially if the provincial rules do not otherwise provide for division of property, dependant’s relief, and/or rights on intestacy. Even where rights exist, other family members may challenge the right of a common-law spouse. Planning by both partners in a common-law relationship can ensure that the succession of property on death is appropriate. If the partners in the relationship want to ensure the surviving partner inherits, well drafted wills can achieve this. If the partners wish not to have each other as beneficiaries or wish to limit the entitlement of the other spouse, it is best to combine estate planning with a binding co-habitation agreement, and property should be held separately – not jointly with a right of survivorship. (Note that such agreements are not effective to waive rights to support, including dependants’ relief in most jurisdictions, although the Courts may take them into consideration.).

4. Terms of a testamentary spouse trust:

   a. Spousal Rollover: The trust must be for the sole benefit of the surviving spouse during the lifetime of the surviving spouse. During the spouse's lifetime, no person except the spouse can receive or obtain any use of any of the capital of income of the trust.

   b. Achieve Maximum Potential Income Splitting/Tax Savings for Children and their Families: After the death of the surviving spouse, the funds in the spousal trust can be divided into separate trusts for each child and his or her family. The trusts should be discretionary as to payments of income, capital, and beneficiaries to achieve flexibility to maximize the use of the marginal rates of the children and their children. Beneficiaries can include the spouse of the child and/or other spouses of grandchildren or more remote issue.

5. A dependants' relief claim (or a wills variation claim in BC) might be appropriate wherever a person who qualifies as a dependant in relation to the deceased (as defined under the provincial legislation) has not been adequately provided for by the deceased. For example, if a minor child of the deceased is not provided for in the Will, a claim might be made on behalf of the child – this might be particularly appropriate, for example, where the other parent cannot otherwise provide support. Similarly, a surviving spouse who is disinherited, or who is left only a portion of the estate might make a claim.

6. Comparison of the estate planning objectives and issues of a married couple with young children to those of a married couple who are 65 or older with older children and grandchildren.

	Married Couple with Young Children	**Married Couple who are 65 or Older with Adult Children and Grandchildren**
a. Choice of Executor	Usually can appoint the spouse, with an alternate who is a cohort (i.e., a brother or sister), since at least one of these is likely to outlive them. Children are minors, or too young for the responsibility.	Spouse may be elderly or pass away first, so alternate or co-executor is important. The executor needs to outlive them, so siblings or friends usually not best – rather adult children if appropriate, otherwise a trust company.

b. Support Obligations	Support obligations to other spouse and children must be considered. Insurance should be considered to provide income replacement for spouse and children, and fund post- secondary education.	Have obligations to other spouse. On death of both spouses, usually have none, so subject to “moral obligations” that some provinces (notably B.C.) have imposed, they are free to dispose of estate to any beneficiary in any manner. If there are dependants (such as a dependant grandchild, or disabled child) these must be provided for – joint last to die insurance could be considered if they qualify, and it is available at reasonable rates.

c. Concerns about Remarriage of Surviving Partner	This is a concern because of the age of the surviving spouse, especially where the survivor may also have children with a new partner. In some cases, a spousal trust could be considered to protect the inheritance of the children of the marriage, but usually only if the estate is large, or the concern is great. Any trust for a surviving spouse might be challenged because of support obligations to spouse. Encroachments	This is usually not a major concern, although awareness of this issue and its relevance in estate planning is growing. A spousal trust may be used, although the concern about support obligations must be satisfied. A trust for a surviving spouse might be challenged because of support obligations to the spouse. Rights to encroach on capital can be restricted or prohibited.

d. Protection of Beneficiaries (other than spouse) Against Family Law Claims	Children are usually too young for this to be an issue.	Often a concern with respect to spouses of adult children particularly if there has already been a marriage breakdown in the family, or the couple strongly disapproves of a child's spouse. Trusts can be used to protect the inheritance. The planning should also take into consideration any protection of inheritance under provincial law that varies under each jurisdiction and often can be lost, such as

Unit Four: Business Estate Planning

Knowledge Objectives

Upon completion of this unit the student will:

- Appreciate how estate plans are tailored to business owners' situations
- Understand the planning needs and opportunities for owner-managers
- Understand post-mortem tax planning strategies and when they are appropriate

Skills Objectives

Upon completion the student will, in relation to the topics listed below, be able to:

- Analyze the client's business structure with a view to determining the extent of his or her interest and ways in which that interest can be maintained for wealth preservation and estate planning purposes
- Examine the applicability of buy-sell agreements in supporting the client's plans
- Illustrate the benefits of a buy-sell agreement and show alternative structures
- Identify and explain key planning strategies for the owner-manager
- Explain an estate freeze and identify when it is appropriate
- Describe the importance of business succession
- Understand how to maximize the use of the lifetime capital gains exemption

Required Textbook Readings

Estate Planning with Life Insurance

Glenn R. Stephens, LL.B.

Chapter 2 – Taxation and Product Overview

Chapter 3 – Life Insurance and the Need for Estate Liquidity

Chapter 4 – Introduction to Corporate-Owned Life Insurance

Chapter 5 – Family Business Succession

Chapter 6 – Using Life Insurance to Fund Buy/Sell Agreements

Wealth Planning Strategies for Canadians

Christine Van Cauwenberghe, B.Comm. (Hons), LL.B., CFP, TEP

Chapter 16 – Business Owners

Introduction

Business owners have unique characteristics and unique estate planning needs. Many of the issues that arise for “owner-managers” (as they are sometimes called) are encountered by other individuals. However, owner-managers have a combination of issues that makes their planning particularly challenging. Their needs tend to be multi-faceted, crossing many disciplines. They may require a variety of advisory services, including accounting, taxation, family law, human resources, business valuation, mediation, insurance, and investment management. Business succession and the need for liquidity are often assumed to be the prime estate planning needs. However, these two issues, while of essential importance, may only be the tip of the iceberg in terms of recognizing the complex issues. In addition, because family members are often involved in the business, there is a blending of family relationships with business matters and this can cause significant emotional overtones that affect the planning process.

Business Estate Planning

The purpose of this Study Unit is to focus on the business owner and examine planning issues and strategies from the perspective of the owner-manager’s circumstances. The ownership of a business is the unifying factor in all the topics covered in this Study Unit. The problem of who will manage the family business when the founder retires or dies, the strategies to achieve this on a tax-effective basis, and the method to pay the tax on the transfer of the business are the three main challenges. Add to this the complexity of the owner-manager’s personal and financial situation, and the advisor has a particularly challenging mix of issues, opportunities, and strategies to identify, understand, evaluate, recommend, and implement. This unit will provide an intermediate-level examination of estate planning for the owner-manager building on the material in the other Study Units and on the student's own professional experience and previous studies.

Some of the topics in this Study Unit overlap others. Chapter 3 of the *Life Insurance* text deals with, among other things, taxation on death and probate fee planning. These sections of Chapter 3 can be reviewed here but should primarily be reviewed in conjunction with Study Unit Two: Personal Estate Planning. Chapters 3 and 4 of the *Life Insurance* text are also included in Study Unit Five and are discussed in more detail there.

Chapter 4 in the *Life Insurance* text is also covered in Study Unit Five – Estate Planning with Life Insurance. It is not expected that the student will master the solutions to the income tax problems created when a life insurance policy is held by an operating company and the policy needs to be transferred out of the company because of an impending sale. Rather it is important to understand how to avoid these tax problems by ensuring that the owner of the life insurance policy is not the operating company.

Unique Characteristics of the Owner-Manager

Not everyone has the kind of ambition and independence it takes to start their own business. Those who do and who succeed share some common attributes. These often include a fierce drive to succeed, a disciplined work ethic, and a single-mindedness of purpose. These attributes contribute to the success of the business. They also have side effects that impact estate planning.

The owner-manager may be so focused on the business to the exclusion of everything else that personal and family relationships suffer. This may result in failed marriages and children who resent their parents and the business. Owner-managers are often in a second marriage and may be particularly sensitive to protecting assets for themselves and their children from family law claims.

The wealth that success brings results in a complex financial situation, both within the business and personally. Owner-managers may not have much time or interest in doing personal financial or estate planning. While they might be very astute at managing money in the business, when it comes to managing their personal financial affairs, this may not receive the same attention.

Unfortunately, wealth also attracts its own problems. Many owner-managers experience lawsuits with business partners and family members over a variety of issues. These often include the ownership, structure, and control of the business, and may occur during lifetime or on the death of the owner-manager. A shareholder agreement may reduce the risk of litigation but negotiating a shareholder agreement and keeping it up to date is often a neglected task along with the estate plan.

Motivating an owner-manager to do estate planning is not always easy. More than one very wealthy owner manager has died without an up-to-date Will or any Will at all. And this may compound problems if no succession plan is in place. Though often reluctant to address their own estate planning needs, once owner-managers focus on a task, they have a sense of urgency about completion. Because estate planning tends to be so complex for owner- managers, they may lose patience and abandon the process before the plan is complete. The advisor can play an important role in working with an owner-manager by convincing them to address their estate planning needs and providing appropriate strategies and recommendations.

One strong motivator for the owner-manager is income tax savings. They may not be motivated by the prospect of their own mortality, but the fear of overpaying taxes on death can often direct their attention to estate planning.

The owner-manager who builds a business from scratch initially will control all aspects of the business. It can be difficult to let go of control as the business grows and delegate to management. This can also make it difficult to develop and implement a business succession plan. If family members or existing management are not being given responsibility that will enable them to run the business in future, the transfer of the business may not operate smoothly. Costly mistakes may be made and there may be an interruption in business operations. If customers, suppliers, lenders, partners and other business relationships essential to the business are personal to the owner-manager, the business may falter when the owner-manager is no longer at the helm.

The owner-manager may put a great deal of trust in one or more advisors whose relationship is long-standing. Sometimes the needs of the owner-manager exceed the expertise of the advisor as the business grows and the business becomes more complex. They also often have practices that are more general in their professional fields, rather than the specific tax and legal expertise the owner-manager requires for a complex estate plan. However, these advisors must be part of the team if the estate plan is ever to be completed. These “trusted advisors” very likely know the individual, know the family, have inside information that may never be shared with an untested or new advisor, and may have a better understanding of the facts than the owner- manager him- or herself. Most importantly, the owner-manager will often make no move without their concurrence. Tax advisors, lawyers, and other professionals who specialize in corporate reorganizations and estate planning for owner-managers are best positioned to work as the "specialists" who work with the owner-manager and his or her family and existing advisors to advise with respect to their particular area of expertise. This approach better wins the goodwill of existing advisors who otherwise may be uncooperative if the relationship with their client appears under threat. Generally, owner-managers remain fiercely loyal to those who have gained their hard-earned trust.

Preparing a business for succession is a whole study in itself that will not be included here. However, it is important to appreciate that this is a process that the owner-manager can master or ignore. If mastered, the business may have a better outlook under the guidance of the founder; new management and ownership will have been transferred in an orderly fashion. If ignored, the future success of the business may be uncertain, and the value of the enterprise built up during the lifetime of the owner-manager may dissipate.

Unique Planning Requirements

A number of planning issues are unique to the owner-manager, including the following:

- Determining how the business will be owned, operated, and controlled after the retirement or death of the owner-manager;
- Resolving how income tax payable on death with respect to the business will be calculated and funded;
- Establishing how the needs of all beneficiaries will be met;
- Finding solutions to solve the problems created where there is an over-concentration of wealth in the business;
- Dealing with the growth and complexity that a successful business brings;

- Understanding that wealth results in additional taxes and attracts claims and litigation; and
- Recognizing that needs may surpass the existing advisors' expertise.

One key question is whether family members will be involved in the succession plan. If children are already working in the business and have taken on leadership roles, the owner-manager may be confident that there is one or more heir apparent to the business. In other cases, there may be an expectation that children will want to own and run the business. However, a reality check may be wise – what the parent wants and what children want, do not always align. There are family business consultants who specialize in facilitating discussions relating to family succession plans. They can be very helpful in ensuring that there is intergenerational agreement and mutual understanding about the future of the business. If parents and children do not have similar visions of the ownership or direction of the business, it is better to find out early in the process rather than have an intricate plan fail when the owner-manager dies because beneficiaries are not on side. There is often sibling rivalry over future control and ownership of the business as well. While the estate planner is not a therapist, the antennae should be up to recognize clues for potential future conflict, and the plan should be designed to minimize as much as possible the opportunity for conflict to sabotage the administration of the estate and the succession of the business.

In examining the succession of the business, the questions below are very relevant to the estate plan.

- Will the business pass to family members or be sold to third parties?
- How will the transfer of control be managed?
- How will the value of the business be shared with the family?
- What is the value of the business in relation to other estate assets?

Taxation of Private Corporations and their Shareholders

The taxation of private corporations and their shareholders is extremely complex, and details are not part of this material or the course. It is expected that the student will have some background in this area, and some self-study will be required if this is not the case. The issues for owner-managers relating to personal financial and estate planning cannot be fully appreciated without an understanding of the principles and rules relating to private corporations and their shareholders. At least a basic understanding of the following will be helpful to this end:

- the small business deduction,
- the capital gains exemption,
- the capital dividend account,
- rollovers available on transfers of property to corporations,
- rollovers available on corporate reorganizations,
- estate freezes,
- crystallization,
- purification,
- tax treatment of investment income within a private corporation and upon distribution to shareholders, and
- the use of the loss carryback rule for capital losses realized in the first year of the estate on redemption of shares.

A general understanding will be sufficient for this course, and students are not expected to be familiar with the details of these rules or concepts except to the extent they are included in the required reading of the Study Unit or any of the case studies.

The student should also be aware that almost anything published relating to income tax is subject to change and is probably out of date already if it contains specific tax rates that are constantly in a state of flux.

For business owners of private corporations, maximizing the utilization of the lifetime capital gains exemption is often a major tax objective. Students should be familiar with this exemption and have a general understanding of the rules relating to the definition of qualifying shares – that is, shares of a qualified small business corporation, and the methods to utilize the exemption in respect of such shares. Using the spousal rollover to defer tax on the business until the death of the surviving spouse, and estate freezes should also be well understood.

Post-mortem tax planning for deceased shareholders of private corporations is complex in the extreme. Tax planning relating to the use of insurance and the capital dividend to fund, purchase or redeem private corporation shares is covered in the *Life Insurance* text in some detail. Students should be aware that neither of the required reading texts provides a complete analysis of the tax planning available for the estates of deceased shareholders or owner-managers.

Leaving the Business to Family Members

If the owner-manager is leaving the business to family members, many decisions must be made regarding the division of the estate. The value of assets is usually divided between business and non-business assets. Beneficiaries may include those who will receive a share in the family business and those who will not. The owner-manager will have to decide how the value of his or her estate will be divided. The examples below provide illustration.

- Is each child to receive an equal share in the value of all assets including the business? This may not be possible if there is an over-concentration of wealth in the business. Insurance to fund equalization among beneficiaries may be one solution.
- If each child is to receive an equal share, will the children receiving the business assets be shortchanged with respect to liquid assets because the bulk of their inheritance is received in the form of shares? Should a discount be applied in valuing the shares of the business since there is an inherent risk associated with owning a business as compared to other assets of the estate such as cash?
- Are some children entitled to a share of the business that is disproportionate to the share that other children are receiving from the estate? One child may be the heir apparent of the business, and the parents may both decide that this particular child deserves to receive a larger share of the estate, usually in the form of a share in the business. The result may be an unequal division of value among children, but one that, due to the child's contribution to the business, is fair.

Providing for the Business in the Will

The terms of the Will of the owner-manager should include broad powers to deal with the business. These include the power to carry on or continue to carry on any business, enter into corporate reorganizations, to sell, to borrow, to pledge assets of the estate, to permit family members to purchase assets of the estate, and where family members are executors or trustees to permit them to purchase assets from the estate. These terms will provide maximum flexibility to the executors and beneficiaries to carry out post-mortem tax planning, and structure the distribution of the business and other assets of the estate. The terms should also permit the sale of the business and retention of assets in their existing form at the date of death. The latter will relieve the executors of the obligation to liquidate the family business or to diversify the investments of the estate.

Where there is no specific succession plan in place, as a temporary measure, the Will might provide for a holding period for the business while management and family have time to arrange for an appropriate post-mortem transfer of the business. For example, the Will could provide that a share of the business be retained for a limited period, such as up to three years. This will relieve the executors of any immediate obligation to distribute the business under the terms of the Will and may permit time to arrange an arm's length sale, management buyout, or transfer to family members.

If a sale of the business is anticipated after death but there is no specific plan, the owner- manager might identify any likely purchasers and leave instructions regarding possible details of any sale for the executor's assistance. For example, some assets, such as trademarks or patents, may have a high value of which the executors might otherwise be unaware. Or the owner- manager may know that particular divisions or aspects of the business can be sold separately for a good price and the balance of the business retained or sold to another purchaser. The owner-manager may also be aware of likely purchasers for the business such as suppliers, customers, or competitors. While these suggestions are a poor substitute for a more specific succession plan, they may be better than nothing, especially if the owner-manager has no Will or an out-of-date Will that does not address current needs or circumstances.

Where a definite succession plan is in place, the Will, the shareholders' agreement (including any buy-sell agreement), life insurance policies and beneficiary designations must all be orchestrated to achieve the appropriate result. Where life insurance is intended to fund a buyout, this should be clearly stipulated so that the life insurance proceeds will be used for the intended purpose and not left to the whims of the executors, corporate beneficiaries, or shareholders or directors of the corporation receiving the proceeds.

The shareholders' agreement should be very specific about the mechanism to be implemented when the corporate-owned life insurance proceeds are received by the corporation, and not left to the discretion of the directors of the corporation, shareholders, or others as disputes could arise. The family of the deceased shareholder might expect (or hope) that a capital dividend will be paid to purchase or redeem the deceased's shares, but the surviving shareholders might have different ideas. The life insurance will be added to the corporation's capital dividend account but will only come out if a capital dividend is declared by the directors. They may declare an income dividend instead.

Ownership of the Family Business

Throughout the rest of this Study Unit it will be assumed that the business is incorporated.

Often the owner-manager will be the sole shareholder of the business. Typically shares are issued on incorporation for a nominal amount. Sometimes shares are issued equally with the spouse, or with the spouse owning some portion of the common shares.

Multiple numbers of shares should be issued to ensure maximum flexibility in future regarding the use of the spousal rollover. For example, if one share is issued, on death the executor can only choose to rollover the entire value of the company or none of it. If 100 shares are issued, the executor has a range of choice from 1% to 100%.

The use of a corporation permits ownership by multiple individuals or entities. It also permits the value, control, and growth of the corporation to be severed into separate classes of shares, each with particular attributes designed to meet particular objectives. Thus, a corporation permits flexibility with respect to designing shareholders' rights.

Owner-managers often participate in a corporate reorganization to crystallize the capital gains exemption. Often this is part of an estate freeze whereby other family members obtain growth shares in the business (i.e., new common shares are issued), and the owner-manager is issued fixed value preference shares. The capital gains exemption has increased several times over the past few years. If a crystallization was completed in the past using only part of the exemption, it may be possible to carry out another reorganization to utilize the remaining portion.

Summary of Key Issues

Planning for business owners is very challenging. There are often multiple complex issues within the family and relating to the business itself. Tax planning, and effective use of insurance to provide liquidity on death for any number of purposes, along with a good succession plan are usually necessary for a smooth transition of wealth and the continuation of the business after death of the business owner.

Motivation is also a challenge. The owner-manager often cannot visualize a future that does not include his or her continued presence. Over time, illness, death of a colleague or family member, or a desire to retire and enjoy life more may be factors in preparing owner-managers for what is a daunting task – the contemplation of death, taxes, and transfer of control and ownership of the business. Family members, particularly the spouse, existing advisors, and business partners often play a role in getting the owner-manager to address succession and estate planning. Surprisingly, fear – either of overpaying taxes, failing to protect the inheritance from a family law claim (from one's own spouse or that of a child), or some other source – will sometimes bring them rushing to the task.

A team of professional advisors can usually best serve a business owner as their requirements almost always cut across many disciplines. No one advisor can master all the expertise required. Recognizing the areas of expertise required, bringing in the appropriate professionals, and working together for the benefit of the client is especially important for the business owner whose needs are so complex.

Review Questions and Answers

Questions

1. Why must fixed-value preference shares be received by the shareholder on an estate freeze? Why must the shares and other consideration received by the shareholder in exchange for the existing shares (in the course of an estate freeze) be equal in value to the existing value of his or her share ownership in the corporation at the time of the freeze? What happens if the value of the corporation used for the purposes of the estate freeze is subsequently challenged by CRA?
2. List four (4) advantages of corporately owned life insurance.

Answers

1. The shares must have a fixed value so that the growth in the value of the corporation will accrue to the new common shares issued to other family members. The consideration received by the "freezor" must equal the value of the shares exchanged. If they are worth less, then a benefit will have been conferred on the common shareholders that will be taxable to the freezor or the common shareholders. If worth more, the new common shares will not have any value until the increase in value of the corporation matches the value of the preference shares and this is not consistent with the purpose of the freeze. If CRA challenges the value, a price adjustment clause may be used to adjust the value of the preference shares. The price adjustment clause must have been incorporated into the terms of the estate freeze, and the original value used must have been reasonably ascertained.
2.
   a. Premiums are payable in cheaper after-tax dollars especially if the corporation qualifies for the small business deduction.
   b. It permits flexible buy out strategies – that is, either purchase or redemption, depending on which is preferred in the circumstances, whereas individually held insurance permits only purchase.
   c. Cash may be available in the corporation and would be subject to tax on payment out to the individual if used personally to fund insurance premiums – either as dividend or salary/bonus.
   d. Owner-managers may be more comfortable using corporate rather than personal dollars to purchase life insurance.

   There may be a taxable event to the corporate owner of the policy if the policy needs to be removed from the company on a sale to a third party; if the operating company is sold, the insurance policy cannot be transferred out of the company on a tax-free basis since there is a disposition of the policy for proceeds equal to the cash surrender value (CSV) with resulting potential adverse income tax consequences. In addition, any transfer of the policy to an employee or shareholder for less than fair market value can result in a taxable benefit to the shareholder or employee.

Unit Five: Estate Planning with Life Insurance

Knowledge Objectives

Upon completion of this unit the student will understand the different types of life insurance and how they can be used to achieve estate planning objectives.

Skills Objectives

Upon completion of this unit the student will be able to assess the need for life insurance to support the estate plan and (in conjunction with the insurance content of other study units) recommend alternative insurance strategies.

Required Textbook Readings

Estate Planning with Life Insurance

Glenn R. Stephens, LL.B.

Chapter 3 – Life Insurance and the Need for Estate Liquidity

Chapter 4 – Introduction to Corporate-Owned Life Insurance

Wealth Planning Strategies for Canadians

Christine Van Cauwenberghe B.Comm.(Hons), LL.B., CFP, TEP

Chapter 25 – Insurance

Introduction

No study of estate planning is complete without the inclusion of life insurance. Understanding the importance and uses of life insurance are integral to the skill set all professionals in estate planning must have. The insurance advisor plays a key role in the uses of insurance and the estate plan however, other professionals must also be familiar with the basics. The insurance advisor may need to rely on other professionals for the details relating to insurance, including trust and tax law, and selecting the appropriate policy holder and designated beneficiary.

Many estate plans fail to properly co-ordinate the insurance planning with the other aspects of the plan and unfortunately often serious deficiencies are not discovered until after the insured has passed away. The lawyer, accountant, and other professionals who work together with the insurance advisor in a team environment will be doing the client and his or her beneficiaries a great service as well as reducing the exposure to potential claims.

The primary role of insurance is funding. Life insurance obviously provides funds on death and this can be utilized for many purposes essential to the effective estate plan.

The Need for Liquidity on Death

Often tax planning is seen as the primary goal of estate planning, although this is quite a myopic view of estate planning as it encompasses many other objectives. Tax savings may often be used to motivate a client to initiate estate planning, and advisors often encourage this view to bring the client to the task. Once the planning has commenced, however, many other objectives become apparent.

Life insurance is primarily used to fund liabilities and other obligations on death but is by no means the sole use of life insurance. For example, it can also be used to provide additional funds to make distribution of the estate to family members fair, or fund charitable gifts. The two objectives of reducing liabilities and funding gifts can be effectively carried out through collaboration among professionals from different fields to ensure that both the client's tax savings are optimized and that the appropriate amount of funding is obtained to achieve the plan objectives. The need for liquidity on death is usually apparent, but specific quantification of the need can make the need for life insurance more compelling. Assuming there are no business assets, a list of the liabilities on death may include the following:

- funeral expenses,
- taxes owing by the deceased in respect of the current and/or previous years,
- taxes owing as a result of death, such as capital gains and taxation of registered plans,
- probate fees,
- executor compensation,
- cost of liquidating assets as part of administration of the estate including appraisals and real estate commission,
- support of spouse and minor children,
- support of continued post-secondary education for an adult child, and
- obligations triggered by death under contracts (such as separation agreements), bank loans or guarantees.

It is often an eye-opening exercise for clients to have an inventory done of all the assets of the estate and funds available on death, along with a calculation of the liabilities arising on death. Ideally these calculations should be done as future projections. However, sophisticated software and many difficult assumptions are required, including date of death of the client and his or her spouse, who dies first, future asset value, and status of obligations on death. An analysis can be done on a present basis, as if the client died immediately. This can bring the actual financial consequences of death into focus and alert the client and the advisor to planning and funding issues.

Business owners have additional requirements for insurance that emanate from a number of factors requiring additional funding on death.

- Taxation of the business owner/shareholder on death
- Desire to pass business to family members creating liquidity problem
- Disproportionate amount of wealth tied up in the business
- Need for equalization to be fair to beneficiaries who do not inherit the business
- Desire to provide all beneficiaries with cash as well as business assets
- Need to fund buy/sell provisions in shareholders' agreements
- Professional fees to design and implement post-mortem planning
- Cash requirements to sustain the business after death of a key employee/owner/manager
- Retire business loans as a term of financing

Liquidity problems for business owners can be acute whether the business is to stay in the family or not. If there are other partners or shareholders in the business, there may be contracts in place to provide for obligatory purchase or redemption on death. If the business is to be sold following death, funds will be required to sustain the business while a purchaser is sought, and to finance the estate expenses during the pre-sale period as privately held businesses are not readily converted into cash.

Factors in Identifying the Need for Life Insurance

Situations requiring insurance typically result from one or more of the following factors:

- property is to be transferred in kind to beneficiaries,
- assets are not readily converted into cash – such as real estate or business interests,
- there is an imbalance in distribution among beneficiaries that requires funding to adjust,
- dependants or other beneficiaries require ongoing support,
- there is significant charitable intent with insufficient funds,
- income tax and other liabilities exceed the cash available on death,
- bank loans or other financing will become due on death,
- there is a desire to secure an inheritance for one or more beneficiaries,
- insurance is required by contract (such as a separation or shareholders' agreement),
- funding is required for a buy-out of a business interest, or
- other needs arising from business interests.

A thorough review of the specific individual's situation and objectives can assist in uncovering insurance needs and opportunities, which may not otherwise be obvious at the outset.

Beneficiary of Life Insurance

It is important to consider the beneficiary of life insurance carefully. In choosing the beneficiary for life insurance, attention must be paid to the purpose of the insurance and many other factors, including creditor protection and probate fees.

For example, often a policy taken out to pay taxes on death or provide liquidity names the children or other beneficiaries of the estate as the beneficiaries of the life insurance. This can be inappropriate, since the legal obligations to be funded are those of the estate, whereas an individual beneficiary of the estate is receiving the insurance proceeds. This is not the right legal result and the insurance beneficiary may be under no obligation with respect to use of the insurance proceeds.

On the other hand, making the estate the beneficiary of insurance can expose the proceeds to creditors of the estate, and subject them to probate fees. Naming a beneficiary by way of an insurance declaration in the Will and appointing a trustee (who may also be the executor of the Will) for insurance is sometimes done with the intent that the proceeds will fall outside the estate to avoid this result. However, based on the Carlisle decision in Saskatchewan, this also must be done carefully.

Note that while a testamentary insurance trust can be created using a designation that is provided in an individual's Will, the designation/declaration must be done in accordance with the Insurance Act. Where the estate is the intended beneficiary of the funds, however, such as where the money is to be used to pay estate liabilities, the inclusion of insurance proceeds in the estate cannot be avoided, exposing the insurance proceeds to probate fees (where applicable) and potential liability to creditors.

Corporately Owned Life Insurance

If insurance is corporately owned, generally the corporation or a related corporation, and not an individual, should be the beneficiary. Otherwise the individual may be subject to a taxable benefit on the premiums, and if the insurance was taken out corporately, it is likely that the original planning intended that the proceeds be added to the corporate beneficiary's capital dividend account (CDA). If this was not intended, perhaps the corporation should not be the owner of the policy.

In addition to the benefits of corporately owned life insurance as outlined in the Life Insurance text, life insurance can be used to fund tax-effective corporate distributions. Because the CDA can be paid tax free to an individual shareholder (either directly or through a corporate chain of capital dividends) the purchase of life insurance can be a tax-efficient way of effecting distribution of corporate funds – the cost of premiums (the funds which would otherwise be paid out of the corporation by way of taxable dividends) is converted into life insurance proceeds, which have been invested in a tax deferred policy, that after death can be paid out tax free from the corporation in the form of capital dividends.

Despite the considerable tax benefits of corporately held life insurance, it is rarely sold or marketed as a "tax shelter" per se. From a policy perspective (fiscal policy), the generous rules in the Income Tax Act for life insurance are based on the presumption that it is a product that primarily is used to deal with mortality and that is not purchased solely because of the tax advantages.

Life Insurance Planning

Just as it is important to think through all the “what ifs” when drafting a Will and designing an estate plan in general, it is imperative that when purchasing life insurance, professionals carefully consider all the implications of:

- the owner of the policy (individual or corporate and which corporation),
- the life insured (joint or single lives, for example),
- the type of insurance (term or permanent),
- face amount,
- beneficiary (or beneficiaries), and
- purpose of the insurance – short term and long term.

The benefit of teamwork among professionals, including the lawyer, accountant, and insurance professional, to make sure all relevant issues are considered and that the structure of the insurance is properly implemented cannot be overemphasized. The Case Studies in the Life Insurance text (dealing with shareholders’ agreements) illustrate some of the serious problems that can result when professionals do not work together. The legal documents (including the Will, beneficiary designation, shareholders’ agreement and buy-sell provisions) should work together and be consistent with each other.

Questions and Answers

Questions

1. List four (4) reasons corporately held life insurance might be held by a holding corporation (Holdco) rather than a subsidiary that operates the on-going business (Opco) and provide a brief explanation for each.
2. List six advantages of corporately held life insurance and provide a brief explanation for each.
3. What is the difference between split dollar life insurance, and split beneficiary life insurance?
4. For each of the following, would term or permanent insurance be recommended? Briefly explain, and if applicable are there any other particular recommendations you would make regarding the insurance?
    a. A husband and wife wish to provide a fund to support a mentally handicapped child.
    b. A shareholder wants to pay the income tax liability arising on death in respect of freeze shares in the business.
    c. A single mother wishes to ensure her children receive post-secondary education.
    d. A corporation wants to ensure additional funds are available if a key employee dies, and also wishes to provide an incentive to the employee to stay with the company.
    e. Under a separation agreement, a father has an obligation to purchase insurance in the amount of $500,000 in lieu of support payments in the event of death payable to the wife until the oldest child is age 25.

f. A business owner who expects to sell his business to his younger partners/co- shareholders in ten years and retire on the proceeds wants to ensure that his wife has sufficient funds to maintain her lifestyle.

g. A business owner has sold the business and wishes to set aside one part of the proceeds to fund his or her own needs and that of the spouse during the remainder of their lifetimes and secure the remaining portion of the proceeds to distribute to other family members or beneficiaries on death.

5. Why should a shareholders' agreement be reviewed in conjunction with insurance planning for a business owner? List your reasons.

Answers

1. Reasons for corporately owned life insurance to be in a holding corporation:

   a. Creditor protection – assets in Opco will be subject to persons who have claims against the business, including creditors and litigants. The insurance proceeds can usually be sheltered from such claims in Holdco (assuming Holdco has not guaranteed the debts of Opco).

   b. Holdco may have more funds available than Opco – if a Holdco is in place, tax-free dividends are often paid up to Holdco as part of a creditor protection strategy. These sheltered funds can be used to purchase the life insurance.

   c. Where there are individual shareholders as well as a corporate shareholder, to preserve Opco's eligibility for the capital gains exemption for the benefit of the individual shareholders – i.e., to help ensure the shares continue to be shares of a qualified small business corporation. The CSV of life insurance is a non-business asset that may disqualify Opco from the 50% test or the 90% test. Holding the policy in Holdco will help preserve the right of any individual shareholder of Opco to the capital gains exemption.

   d. To permit tax-free retention of the policy if Opco is sold to a third party. If the policy is held in Opco, a subsequent transfer of the policy may attract severe income tax consequences.

2. Advantages of corporately held life insurance:

   a. The funds may be available in the corporation if not available personally.

   b. In most cases, the cost is more tax efficient than paying from personal funds because corporations typically pay tax at a lower rate than individuals, and therefore need to earn less income in order to have the same after-tax dollars with which to pay premiums.

c. The client may find it more attractive from a psychological standpoint to have the corporation pay rather than pay the premiums personally.

d. The CDA provides for tax-efficient distribution of the proceeds of the policy from a corporation to an individual shareholder.

e. Corporately held insurance is more flexible for post-mortem planning permitting either redemption of shares held by the deceased, or purchase of the shares by another shareholder, depending on the desired tax treatment, including the availability of the section 164(6) loss carryback in the case of a redemption, or the use of the capital gains exemption in the case of a purchase.

f. Corporately held insurance may be seen as more secure and better suited to fund buy-sell obligations between arm's length parties especially where there are policies on the lives of multiple owners, and differences in premium costs can be better managed.

3. In split-dollar life insurance, the cash value and face amount of the policies are owned by different persons and each can name a beneficiary of their respective interests; whereas in split beneficiary insurance, there is only one policy owner who names two or more separate beneficiaries under the policy.

4. Identify term or permanent insurance, with brief explanation, along with brief recommendations, if any:

a. Permanent – the child's needs will continue during and after the parents' lifetime. The parents may want to secure the child's future financial needs with a policy that is creditor protected. A joint last-to-die policy may be appropriate as premiums may be reduced on the assumption that the parents will fund the child's needs during both their lifetimes. If the estate plan includes the use of a Henson trust or qualified disability trust in the parent's Will, then the disabled child should not be designated as the direct beneficiary of the insurance policy.

b. Permanent – assuming the shares will be held until death and not redeemed – the tax liability is crystallized on a freeze so life insurance provides the perfect funding – the timing matches the liability, and the amount required can be quantified when the policy is purchased. If there is a spouse who will inherit the freeze shares first, joint last-to-die might be considered.

c. Term – the insurance need will end when the child completes post-secondary education. If he or she has no other insurance needs, term should be sufficient, and the most cost effective for this need.

d. Permanent insurance – to meet the needs of the key employee – although term may be all that is needed by the corporation – this may be a good situation for split dollar or split beneficiary insurance.

e. Term – the obligation ceases after the youngest child attains age 25.

f. Permanent –universal life insurance may provide the most flexibility here (to fund a buy-sell if he dies before a sale to his partners is completed, and to provide a tax-effective way of distributing funds from his business) assuming he will have a Holdco and that some of the proceeds will be held corporately; and to enable him to make additional deposits to the policy once he has the proceeds of the sale to fund growth of the cash value.

g. Permanent insurance – the investment and creditor protection aspects of universal life insurance will provide the security he or she desires and maximize the amount of the inheritance.

5. Reasons to review the shareholders' agreement in considering insurance planning for business owner:

   a. To understand and review the obligations and/or needs that require funding, including:

      - What is the provision for disability?
      - What are obligations on death of a shareholder?

   b. To ensure there is a reasonable method to determine the price at which any buy-sell will take place.

   c. To determine, in conjunction with the client's other advisors, whether there is a tax-efficient buy-sell structure in place.

   d. To ensure the agreement is consistent with the insurance plan.

   e. To obtain information about the corporate structure and business owners – i.e., to help consider who should be the life insured(s), which corporations are candidates for the policy owners, and how the premiums should be funded.

   f. To confirm that a legally binding shareholders' agreement has actually been put in place (not just an unsigned draft).

Unit Six: Foreign Aspects of Canadian Estate Planning

Knowledge Objectives

Upon completion of this unit the student will:

- Understand how laws of other countries may apply to Canadian estates
- Understand how U.S. estate tax and U.S. gift tax can affect Canadians
- Understand key offshore planning concepts

Skills Objectives

Upon completion the student will, in relation to the topics listed below, be able to:

Offshore Planning Basics

- Explain the key offshore planning opportunities and the importance of specialized advice
- Describe the limitations of offshore planning
- Understand how laws of other jurisdictions may affect succession of property
- Recognize situations in which foreign succession law may apply to Canadian estates

U.S. Estate Tax Planning

- Identify potential exposure to U.S. estate and gift taxes for U.S. citizens resident in Canada
- Identify situations in which Canadians who are not U.S. citizens may be subject to U.S. estate and gift tax
- Identify the client's U.S. assets and discuss their effect on the client's wealth transfer and estate planning
- Describe the planning strategies that may reduce the cost of U.S. estate tax
- Explain the need for specialized expertise to advise on U.S. issues

Topics Covered

- Basics of Offshore Tax Planning
- Basics of Taxation of Foreign Trusts in Canada
- U.S. Estate Tax for Canadian Residents including U.S. citizens, resident aliens and non-resident aliens of the U.S.
- U.S. Gift Tax for Canadian Residents including U.S. citizens, resident aliens and non-resident aliens of the U.S.

Introduction

With an increasingly globalized world, it is much more common to find that a Canadian advisor in preparing and implementing an estate plan for a Canadian resident must also consider the application of the laws of another jurisdiction.

Canadian residents who plan to leave an inheritance to a loved one who lives abroad or a beneficiary who may one day move abroad may have to navigate international estate and tax laws. Estate planning in such situation is made more complex because each country has its own tax and compliance requirements. The best approach to estate planning is to be pro-active in considering the rules on both sides of the border. While Canada taxes unrealized capital gains on death other countries impose other types of tax on death including estate or succession tax. While some countries tax the estate of the deceased, others tax the beneficiary. While most countries like Canada tax based on residency, others tax based on citizenship, domicile or where the deceased's assets are located.

The purpose of this study unit is to ensure that financial advisors are able to identify situations where foreign laws may impact estate planning for Canadians. Most importantly, the advisor should be able to recognize those scenarios where he or she should seek advice from another expert, usually a professional who regularly deals with the law of the other jurisdiction or a professional practicing in that other jurisdiction.

This study unit does not include issues relating to non-residents of Canada. It confines itself to a discussion of how residents of Canada may be affected by the tax and succession laws of foreign jurisdictions.

Because of the proximity of the U.S. to Canada and the regular travel and business dealings undertaken by Canadian individuals in the U.S., we will focus on how U.S. laws can impact estate planning for Canadians who own property in the U.S. We will also discuss planning for U.S. citizens or U.S. green card holders who are subject to both U.S. and Canadian income tax on their world-wide income and generally are subject to U.S. gift and U.S. estate tax on their world-wide estate.

Impact of Foreign Laws on Canadian Estates – Overview

Advisors who provide financial planning for residents of Canada may need to consider foreign aspects of estate planning when dealing with individuals who:

- own property located in a foreign country
- regularly spend time in a foreign country
- are inheriting assets from a foreign country
- are leaving assets to non-resident beneficiaries

These aspects are discussed in the first part of this study unit. If the Canadian resident is a citizen of another country, the estate planning may also be affected by the laws of that country.

This will be illustrated in the latter part of the study unit which focuses on U.S. tax issues as they relate to Canadian residents.

Canadian Residents who own Foreign Property

While Canada does not have an inheritance or estate tax, a Canadian taxpayer is deemed to dispose of all of his or her assets on death and this deemed disposition may result in income and capital gains that are taxed at death. In addition, provincial probate fees may also apply.

When a Canadian taxpayer owns a foreign property, he or she should review whether provincial probate fees (based on where the taxpayer resides immediately prior to his death) will apply to the foreign property.

The Canadian resident may want to consult with an accountant or lawyer in the jurisdiction where the property is located in order to understand the tax ramifications in that other country and the local laws of succession that would apply. It is better to consult with these foreign experts when the estate plan is being developed rather than discovering those problems while administering the estate.

A Canadian will may not be recognized in the foreign jurisdiction where the property is situated. The Canadian owner should ensure that the Canadian will is reviewed by a lawyer licensed to practice in the jurisdiction where the property is located. The foreign lawyer may recommend that a separate will is prepared in the other jurisdiction that deals with the property located in that jurisdiction. In that case, it is important that the Canadian lawyer reviews the foreign will to ensure there is no conflict between the two wills and that neither will revokes the other. In some instances, a client who owns foreign property may not need a will to be able to leave an inheritance to their heirs. In some countries, the title of the property is transferred by the executor or personal representative. In other countries, the property vests in the decedent's heirs immediately upon the death of the decedent. If the property will vest in the decedent's heirs as desired, then drafting a separate will may be a moot point.

Potential exposure to double tax

Another issue that could arise is exposure to double taxation. It is prudent to inquire whether death tax, estate tax, inheritance tax or other succession duties may be imposed on the death of the Canadian owner by the jurisdiction in which the foreign property is located. If such inheritance taxes and duties apply, these are generally only imposed on immoveable property (including real estate, property used in a business, livestock and equipment used in agriculture and forestry, mineral deposits, sources or other natural resources) that is situated in the foreign jurisdiction.

The STEP[1] Yearbook contains summaries of income and inheritance taxes for many jurisdictions. Canada has entered into a large number of tax conventions or agreements (referred to as tax treaties) with other countries. Generally, the main purpose of a tax treaty is to prevent double taxation, prevent tax evasion and encourage cross-border trade efficiencies. The treaties define what taxes are covered by the treaty, who is a resident and who is eligible for the benefits of the treaty. The tax treaty will often work to reduce tax withheld from income paid from a resident in one country to a resident of the other country. Most but not all of the treaties are based on the Organisation for Economic Co-operation and Development ("OECD") model that exempts capital gains on moveable property owned by a non-resident of a particular country.

If, on the passing of an immovable property on death, capital gains tax is imposed by the foreign jurisdiction and a treaty exists between Canada and that jurisdiction, the taxpayer will generally be able to claim a foreign tax credit against Canadian taxes payable for the foreign tax that was paid. The foreign tax credit may reduce or even eliminate the tax payable as a result of the deemed disposition that occurs on the death of the Canadian resident.

[1] STEP (Society of Trust and Estate Practitioners) is the leading international organization for practitioners in the field of trust and estate planning, including lawyers, accountants, financial planners, insurance advisors and trust professionals, and confers the TEP designation on the most experienced members. STEP Canada has branches in the major Canadian cities and provides education, training, representation and professional development activities for its members.

Determining whether any complications could arise and managing those complications may require a competent cross-border specialist with knowledge of tax laws in both jurisdictions or a team of tax specialists who are able to co-ordinate their advice.

Canadian Estate with a Non-Resident Beneficiary

Distributions from an estate are either from income or capital. When a Canadian estate makes a distribution of income to non-resident beneficiaries, that distribution is generally subject to withholding tax. The general withholding tax rate is 25% but this amount may be reduced pursuant to a tax treaty between Canada and the country in which the non-resident beneficiary resides.

The withheld tax must be remitted to the Canada Revenue Agency and additional forms and slips may be required to be filed to report the income distributed and foreign tax withheld. The non-resident beneficiary would receive copy of the non-resident slip and may be able to claim a foreign tax credit for the Canadian tax withheld in his or her country of residence. If the withholding tax is not withheld or remitted properly, the trustees of the estate can be held personally liable for the withholding tax and penalties may be applied.

While income retains its character when it is distributed from a Canadian estate to its Canadian beneficiaries, this is not always the case when the income is distributed to a non-resident beneficiary. So a dividend or capital gain distributed to a non-resident beneficiary may be taxed as ordinary income in the hands of the non-resident beneficiary where they reside.

When a Canadian estate makes a distribution of capital to its Canadian beneficiaries, that transfer can occur on a “rollover” basis which means that the beneficiary can receive capital with a cost base equal to that of the deceased's estate (usually the fair market value of the property on death). This rollover is not available for non-resident beneficiaries. To illustrate consider the following example:

- Mr. A dies on January 1 with 200 shares worth $200.
- On June 30, the estate distributes these shares which are now worth $320 equally to two beneficiaries. One beneficiary resides in Canada and the other does not.
- The Canadian beneficiary receives 100 shares with a cost of $100 and no tax is payable on the distribution.
- The estate is considered to have disposed of the remaining 100 shares at their fair market value $160 and the gain is taxed in the hands of the estate.

To manage the tax liability of the estate, the executor, pursuant to the terms set out in the will, may arrange to distribute cash or those assets with a fair market value close to its cost base to the non-resident beneficiaries and to transfer those assets with larger gains to Canadian beneficiaries.

When a Canadian estate makes a partial or full distribution of capital to a non-resident beneficiary of the estate, CRA has historically taken the position that the non-resident beneficiary is deemed to dispose of his or her interest in the estate. This interest was always considered to be "taxable Canadian property" and the taxpayer was therefore required to file a Request for a Section 116 Compliance Certificate, obtain a compliance certificate and file a T1 return with CRA to report the disposition. This caused quite a compliance burden when capital was distributed in the form of cash and no tax was payable (because the cost of the interest and the estate and the fair market value of the distribution is the same). In an effort to ease this burden, Budget 2010 amended the definition of “taxable Canadian property” and, effective 2009, a compliance certificate is no longer required when an estate makes a distribution to a non-resident beneficiary unless the estate derives more than 50% of its value from Canadian real property (or certain resource or timber property in Canada).

If more than 50% of the fair market value of the estate is attributable to real property located in Canada at any time in preceding 60 months prior to the distribution, the following procedures must be followed:

1. The estate trustee or trustees must require that the non-resident obtain a compliance certificate from Canada Revenue Agency when distributions of capital are made.
2. The T2062 Request for a Section 116 Compliance Certificate can be filed in advance of the distribution and must be filed within ten days after the distribution. A separate request must be filed for each distribution (partial or full).
3. Where income is distributed, 25% of the income allocated must be withheld and remitted to the CRA with the request and where property is distributed, 25% of the estimated capital gain must be withheld and remitted to the CRA. Where only cash is distributed, the cost and fair market value are equal which means that no withholding tax has to be remitted with the request.

If a request is not filed, the estate trustees may be personally liable for failure to deduct and remit the 25% withholding tax (the amount withheld may be reduced as a result of the treaty between Canada and the country in which the non-resident beneficiary resides) and for the tax payable by a non-resident beneficiary in respect of distributions of taxable Canadian property.

It is important for the Canadian who intends to leave money to a non-resident beneficiary to check the domestic laws of the foreign country where the beneficiary resides to determine what tax implications could arise abroad as a result of the inheritance and whether relief is available pursuant to a tax treaty between Canada and that country. Some countries in the European Union for example, impose gift or inheritance tax which is payable when the beneficiary when they receive a gift. The country may provide an exemption for a certain total value of gifts received during the recipient's lifetime or may take the recipient's taxable income into account. A clause in the Canadian will that requires the Canadian estate to pay for all debts and taxes upon death so that all beneficiaries receive the same after-tax amount could be problematic. In such a scenario, the inheritance taxes levied outside of Canada would be borne by the estate and effectively shared by all the beneficiaries. As you can see, these foreign taxes do need to be considered when drafting the Canadian will. The starting point may be to determine whether the burden of these foreign taxes falls on the estate or the beneficiary.

Canadian Estate with a Non-Resident Executor

Most advisors will recommend that a non-resident executor is not selected because it can cause a myriad of complications. One practical reason is that it is difficult to administer the Canadian estate from abroad. Having a non-resident executor may also create a question as whether the estate is considered a resident of Canada because the executor of the estate is a non-resident of Canada.

When a Canadian resident passes away, the estate is considered a trust. The executors are trustees. The residency of a trust is a question of fact. There have been no statutory rules or criteria that have been set out to determine the residency of a trust. The Canadian courts have determined the residency of a trust and traditionally looked to the residency of the executors to determine if an estate is taxable in Canada. In situations involving an even number of trustees residing inside and outside of Canada, then traditionally the courts looked to the location of the estate assets and the jurisdiction where the legal rights with respect to those assets were enforceable.

More recently, the courts have indicated that the residency of a trust should be determined in the same way that residence is determined for corporations. That is to say that the trust will be considered resident where the central management and control of the trust abides.

This means that if a Canadian resident has selected a non-resident executor, then the estate may also be considered non-resident trust which could have significant tax implications. A non-resident estate may not be able to distribute income to Canadian resident beneficiaries that retains its character. The non-resident estate may not have the option of splitting the tax burden between the trust and its Canadian beneficiaries and if the estate becomes non-resident while the executors during the administration of the estate, the estate could be deemed to have disposed of its assets at fair market value at that time.

It may help to appoint more than one executor to avoid having the estate become a non-resident estate should one executor move abroad. The executor may also be able to renounce their appointment prior to moving abroad. If it is unlikely that an executor will remain in Canada and no one else is able to act as executor, it is also possible to appoint a corporation that provides professional trustee services to administer the estate.

Similarly, if a Canadian executor makes all the decisions and has oversight responsibility for the estate of a foreign person, that estate may be considered a resident of Canada and subject to tax in Canada. In that case, the estate could be faced with double tax. It is important for a Canadian executor of a foreign estate to obtain professional advice so that mistakes like missing deadlines, ignoring local rules or distributing assets without proper clearance are avoided.

Foreign Trust Deemed Resident

A non-resident trust may be subject to tax in Canada under special provisions in the Income Tax Act that are designed to ensure that income earned indirectly by Canadian taxpayers through foreign intermediaries is not taxed at a more favourable rate than would be the case were the income earned without the involvement of those intermediaries. These complex rules are known as the Foreign Investment Entity ("FIE") Rules which were proposed with a retroactive effective date and since that time these rules have been subject to many revisions.

The FIE rules ensure that a non-resident trust is subject to Canadian tax on its world-wide income if there is a resident beneficiary of the trust or a resident contributor to the trust. In order for there to be a resident beneficiary, there must be a beneficiary resident in Canada and there must be a connected contributor who was a resident in Canada within five years (before or after) of the time of contribution. A resident contributor is an individual who has transferred or loaned property to a trust and who is a resident of Canada.

The rules are broad and can encompass many innocent estate planning transactions that involve non-resident trusts. It is prudent to obtain expert tax advice when dealing with offshore trusts.

Canadian taxpayers who loan or transfer or contributes funds to a non-resident trust must file Form T1141 Information Return in Respect of Transfers or Loans to a Non-Resident Trust to report such transactions.

Significant penalties may be applied if this information form is filed late, filed incorrectly or not filed.

Foreign Gifts or Inheritance Received by a Canadian

Generally an inheritance received by a beneficiary in most countries can be received without being subject to gift tax or inheritance tax. It is more practical to tax the person who makes the gift or the estate of the deceased.

Receiving an inheritance from a foreign country is not subject to Canadian tax if the funds are coming from an estate as capital. The distribution could consist of cash or assets.

If the foreign estate distributes shares to the Canadian beneficiary, the beneficiary will inherit those assets with a cost base equal to the fair market value of the assets when they are received from the estate. Any income/capital gains or losses realized after that time will be subject to tax in Canada.

A Canadian resident beneficiary who receives foreign real estate may be required to report their ownership over that foreign property annually. If the foreign property will be used personally as a residence, no annual reporting is required, and a future capital gain could potentially be sheltered by claiming the principal residence exemption. However, if the Canadian resident decides to rent the foreign real estate out for profit, the rental income may be subject to tax in the foreign jurisdiction and the income and reasonable expenses incurred to earn that income will also need to be reported on their Canadian return. When the Canadian resident sells the property, they will be required to pay tax in the foreign jurisdiction and to report the disposition of the property in that country. The disposition also will need to be reported on their Canadian return. A foreign tax credit may be available to be claimed for the foreign tax paid on the rental income or capital gain which may mitigate or even eliminate the Canadian resident's exposure to double tax.

In addition to the above tax consequences, the Canadian resident may also be required to file some information returns. If the Canadian beneficiary receives certain foreign property with a cost base in excess of $100,000 CAD or, as a result of the inheritance, now owns certain foreign property with an aggregate cost in excess of $100,000 CAD, then the beneficiary would be required to file a T1135 Foreign Income Verification Statement annually. A special exception applies for foreign property that is exclusively used personally. Significant penalties may be applied if this information form is filed late, filed incorrectly or not filed. These penalties may be levied even if all foreign income received from the foreign property was fully declared on the beneficiary's tax return.

It is important to determine what the tax consequences are when a distribution is received. The timing of the distribution is also important. If a foreign estate distributes income to a Canadian beneficiary, the income can be subject to tax in the foreign country where the income is sourced and in Canada. If proceeds are distributed to Canadian-resident beneficiaries in the year following the sale of an asset, the foreign estate would pay tax on the disposition and the distribution to the Canadian resident beneficiary is converted from income to capital and no Canadian tax would be payable.

If a Canadian beneficiary receives a distribution or loan from a non-resident (or foreign) trust, the beneficiary may be required to complete T1142 Information Return in respect of distributions from or indebtedness to a non-resident trust. Significant penalties may be applied if this information form is filed late, filed incorrectly or not filed. There is an exception for distributions received from an estate that arose on and as a consequence of death therefore it is important to distinguish from whom the inheritance is received. Inheritances may not always be received from an estate, sometimes inheritances are received from a non-resident testamentary trust in which case the T1142 may be required to be filed.

U.S. Estate and Gift Tax for Canadians – Overview

Whenever the laws of a foreign country are examined with respect to their effect on a Canadian individual, caution must be exercised. This is particularly true with respect to the U.S. estate and gift tax rules. It is important to recognize where U.S. issues arise, and when to refer the client to professionals who have expertise in cross-border Canada/U.S. planning.

There is much confusion relating to these U.S. rules as information available in the media and that written by experts often does not distinguish or define clearly to whom the information could apply. For example, the rules apply very differently depending on which of the following categories any particular individual may fall:

- U.S. citizens who reside in the U.S.
- U.S. citizens who reside in Canada
- U.S. green card holders who are domiciled in the U.S.
- Canadian residents who are non-resident aliens of the U.S.

Whenever a person who resides in Canada is a U.S. citizen or U.S. green card holder, owns property in the U.S., or spends a lot of time in the U.S., advisors should exercise caution. Planning for such individuals is very complex and necessitates the involvement of a U.S. tax professional to avoid costly mistakes.

Often a team is necessary with both Canadian and U.S. experts, each of whom have knowledge and experience in dealing with cross-border planning, the laws of both Canada and the U.S., and the effect of the Canada/U.S. Tax Treaty on both.

U.S. Citizens and U.S. Green Card Holders Living in Canada

U.S. Income Tax – U.S. citizens

Unlike Canada and most other countries world-wide, the U.S. taxes its citizens on their world-wide income wherever they reside. U.S. citizens living in Canada are required to file an annual U.S. tax return to report their worldwide income, including their Canadian source income. As a resident of Canada, U.S. citizens living in Canada also have to file an annual tax return with the Canada Revenue Agency (CRA) reporting their worldwide income.

Where an individual is subject to income tax in both Canada and the U.S. the double tax that could result is generally managed through the provisions of the Canada-U.S. Tax Treaty. The treaty in certain circumstances allows for a foreign tax credit to be claimed that offsets the tax payable in one country for tax paid in the other country. The country where the income is sourced is entitled to collect tax first.

Consider, for example, a U.S. citizen who lives in Canada but who earns pension income in the U.S. of $50,000 USD and who is subject to tax on that income at 35% in the U.S. Let's assume for illustrative purposes that $1.25 CAD = $1.00 USD. In Canada, the $62,500 CAD is included in income and subject to tax at 40%. The individual would be able to claim a $21,875 CAD foreign tax credit for U.S. tax paid to offset the $25,000 CAD tax payable. The balance payable to CRA in this case would be $3,125 CAD.

If the U.S. citizen lives outside of the U.S. and has a bona fide residence in that country, he or she may also be able to claim a foreign earned income exclusion of non-U.S. source income on his or her U.S. return. If the foreign earned income exclusion is claimed, the U.S. taxpayer is prevented from also being able to claim a foreign tax credit for the U.S. tax paid on such income. The table below contains the foreign earned income exclusion amount which is indexed on an annual basis:

Year	**Foreign Earned Income Exclusion Amount (USD)**
2021	TBD*
2020	$107,600
2019	$105,900
2018	$104,100
2017	$102,100
2016	$101,300
2015	$100,800
2014	$99,200
2013	$97,600

* Generally the IRS announces its official inflation adjustments at the end of October of the prior year.

In this manner, double tax can generally be mitigated or eliminated but the individual will ultimately find that he or she is subject to the higher rate of tax between the jurisdictions.

Mismatches can also arise. For example, where a U.S. taxpayer who resides in Canada invests in a TFSA, the income earned in that account is not subject to tax in Canada. While the IRS has not provided an opinion, most U.S. tax professionals agree that the income earned in a TFSA will have to be included in income on the U.S. tax return that is filed and is therefore subject to U.S. tax. There is no way to recover the U.S. tax paid on such income by claiming a foreign tax credit as the income in the TFSA is exempt from tax in Canada.

U.S. Income Tax – U.S. Green Card Holders

A U.S. green card holder is a resident alien for U.S. tax purposes and is required to file a U.S. tax return annually to report his or her world-wide income. A U.S. green card holder will continue to be considered to be a U.S. resident unless the U.S. green card holder has received an official notice from the U.S. Citizenship and Immigration Service that there has been a final administrative or judicial determination that his or her green card has been revoked or abandoned. Where a U.S. green card has expired, additional steps will need to be taken to relinquish or abandon the green card.

There are a number of ways that a U.S. green card holder who is subject to tax both in Canada (as a resident) and the U.S. (as a resident alien) may be able to mitigate his or her exposure to double tax. Like U.S. citizens, green card holders may be able to claim foreign tax credits or the foreign earned income exclusion.

A U.S. green card holder with closer residential ties to Canada may also be able to claim a treaty exemption under the tie-breaker rules found under the Canada-U.S. tax treaty. The tie-breaker rules look at the taxpayer’s centre of vital interest and personal and economic ties. If the taxpayer’s centre of vital interests is in Canada, he or she will be deemed to be a resident of Canada and a non-resident alien of the U.S.

However, claiming a treaty exemption may have unintended tax consequences including:

- The U.S. green card holder terminates his or her U.S. residency status for federal income tax purposes and may be subject to expatriation tax
- The U.S. green card holder continues to be considered to be a U.S. resident for purposes other than determining the U.S. income tax liability and will therefore still be subject to the annual reporting obligations as a U.S. resident
- The U.S. green card holder may be prevented from renewing his or her Green card or applying for U.S. citizenship

U.S. Gift and Estate Tax – U.S. Citizens and Persons Domiciled in the U.S. (resident aliens)

In addition to being taxed on their world-wide income in the U.S. regardless of where they reside, U.S. citizens or U.S. green card holders domiciled in the U.S. are subject to gift and estate tax on their world-wide assets (not just their U.S. situs property).

Please note that the concept of domicile for estate tax purposes is not the same as the concept of residence used for income tax purposes. The analysis of whether a person is domiciled in the U.S. looks at the following factors: duration of stay in the U.S. and other countries, the frequency of travel between the U.S. and other countries as well as between locations abroad; the size, cost and nature of dwelling places and whether these are rented out or owned; the location of valuable possessions, family and close friends, church and club memberships and business interests. Where a U.S. green card holder establishes a domicile in Canada and intends to remain in Canada indefinitely, the U.S. green card holder may be considered to not have domicile in the U.S. and would not be subject to U.S. gift and estate tax on their world-wide estate.

U.S. gift and estate tax are integrated. Gift tax is levied on the transfer of property to another taxpayer for no consideration or less than fair market value consideration during one's lifetime. Estate tax is levied on the fair market value of the world-wide estate when a U.S. citizen (no matter where they reside) or person domiciled in the U.S. dies. The maximum rate of gift and estate tax is 40% on lifetime gifts or taxable estates in excess of $1 million.

The computation of the gift and estate tax for US citizens, those domiciled in the U.S. (resident alien) and non-resident aliens uses the same table (see the table below) but the availability of tax credits to offset the tax calculated is not necessarily the same.

Taxable Estate	**Tentative Federal Tax**
Less than $10,000	18% of such amount
$10,000–$20,000	$1,800 + 20% of excess over $10,000
$20,000–$40,000	$3,800 + 22% of excess over $20,000
$40,000–$60,000	$8,200 + 24% of excess over $40,000
$60,000–$80,000	$13,000 + 26% of excess over $60,000
$80,000–$100,000	$18,200 + 28% of excess over $80,000
$100,000–$150,000	$23,800 + 30% of excess over $100,000
$150,000–$250,000	$38,800 + 32% of excess over $150,000
$250,000–$500,000	$70,800 + 34% of excess over $250,000
$500,000–$750,000	$155,800 + 37% of excess over $500,000

Taxable Estate	Tentative Federal Tax
$750,000–$1,000,000	$248,300 + 39% of excess over $750,000
Over $1,000,000	$345,800 + 40% of excess over $1,000,000

For a U.S. citizen or resident alien, the lifetime gift and estate tax exclusion amounts for purposes of determining estate and gift tax are also integrated. The lifetime gift and estate tax exclusion amount is used to calculate the unified estate tax credit which offsets the amount of U.S. estate tax payable on an estate with a world-wide value equal to or less than the lifetime gift and estate tax exemption amount. The table below sets out the lifetime gift and estate tax exclusion amount for a U.S. citizen or resident alien.

Year	Lifetime Gift and Estate Tax Exclusion Amount (USD)	Unified Estate Tax Credit (USD)
2021	TBD*	TBD*
2020	$11,580,000	$4,577,800**
2019	$11,400,000	$4,505,800
2018	$11,180,000	$4,417,800
2017	$5,490,000	$2,141,800
2016	$5,450,000	$2,125,800
2015	$5,430,000	$2,117,800
2014	$5,340,000	$2,081,800

* Generally the IRS announces its official inflation adjustments at the end of October of the prior year.

** $4,577,800 is the U.S. estate tax payable on $11,580,000 of assets.

Significant changes were made to gift and estate tax under the *American Taxpayer Relief Act of 2012*. For 2013 and subsequent years, when both spouses are U.S. citizens, any lifetime gift and estate tax exclusion amount not fully utilized by one spouse can be carried over and used by the surviving spouse. As a result, when both spouses are U.S. citizens, the lifetime gift and estate tax exclusion amount of each spouse can effectively be combined (for example, $23,160,000 for deaths occurring in 2020). Further changes were made on December 22, 2017 when the Tax Cuts and Jobs Act was enacted. The lifetime gift and estate tax exclusion amount was effectively doubled for taxation years 2018 through 2025. The lifetime gift and estate tax exclusion amount for 2020 is therefore $11.58 Million rather than $5.6 Million. This is a significant change which may present a planning opportunity. For example, the increased lifetime gift and estate tax exclusion amount allows a married couple who previously used up their lifetime gift and estate tax exclusion amount to transfer additional amounts to their descendants without being subject to federal gift tax. The increase in the exemption amount is temporary and the exemption amount is scheduled to revert back to the $5 Million amount (indexed annually) on January 1, 2026 unless permanent legislation is enacted prior to that time.

U.S. Estate Tax

Every U.S. citizen and resident domiciled in the U.S. is entitled to claim the lifetime gift and estate tax exclusion amount. The estate tax exemption amount for 2020 amounts to $11.58 Million US which means that the U.S. estate tax liability for those who pass away in 2020 with a taxable estate that doesn’t exceed $11.58 Million US would be completely offset by claiming the unified estate tax credit (assuming the exemption was not previously used to shelter taxable gifts which is discussed below).

If the assets in the estate are left to a surviving U.S. citizen spouse, then the estate may also be able to claim an unlimited marital deduction under U.S. domestic law. The unlimited marital deduction ensures that no estate tax is imposed on bequests made to the U.S. citizen spouse at death. If the surviving spouse is not a U.S. citizen, then the estate may be able to claim a marital credit or an unlimited marital deduction if the asset is transferred to a trust for the benefit of a surviving non-U.S. spouse provided the trust meets certain conditions.

U.S. Gift Tax

U.S. citizens and resident aliens are also required to track their annual gifts. There is an unlimited exclusion for gifts made to a spouse who is also a U.S. citizen, an annual exclusion amount for gifts made to a spouse who is not a U.S. citizen and an annual exclusion amount for gifts made to persons other than a spouse (children for example). The annual gift tax exclusion amount is determined per recipient which means that annual gifts to any number of individual recipients may be made without having gift tax apply.

The table below contains the annual gift tax exclusion amounts.

Year	Annual Exclusion Amount for Gifts to a Spouse who is a U.S. Citizen	Annual Exclusion Amount for Gifts to a Spouse who is not a U.S. Citizen (USD)	Annual Exclusion Amount for Gifts to Others (USD)
2021	Unlimited	TBD*	TBD*
2020	Unlimited	$157,000	$15,000
2019	Unlimited	$155,000	$15,000
2018	Unlimited	$152,000	$15,000

Year	Annual Exclusion Amount for Gifts to a Spouse who is a U.S. Citizen	Annual Exclusion Amount for Gifts to a Spouse who is not a U.S. Citizen (USD)	Annual Exclusion Amount for Gifts to Others (USD)
2017	Unlimited	$149,000	$14,000
2016	Unlimited	$148,000	$14,000
2015	Unlimited	$147,000	$14,000
2014	Unlimited	$145,000	$14,000
2013	Unlimited	$143,000	$14,000

* Generally the IRS announces its official inflation adjustments at the end of October of the prior year.

Gifts made within the annual gift tax exclusion amount do not reduce the U.S. citizen or resident alien's lifetime gift and estate tax exclusion amount. However, the value of the gift in excess of the exclusion amount

A U.S. citizen or resident alien who makes gifts in excess of the annual exclusion amounts is required to file a gift tax return.

The U.S. also imposes a generation skipping transfer tax which effectively doubles the gift tax exposure when a gift bypasses the next generation for a later generation. This could apply for example, when a grandparent makes a gift to a grandchild.

Canadian residents who spend time in the U.S. or own property in the U.S.

U.S. Income Tax

A person who is not a U.S. citizen or U.S. green card holder may still be subject to U.S. taxation on worldwide income if he or she has a "substantial presence" in the U.S.

The substantial presence test determines residency based on the number of days the individual was present in the U.S. on a rolling 3-year formula. For the purpose of the substantial presence test, each partial day of presence is counted as a full day in calculating days spent in the U.S.

An individual will be considered to have a substantial presence in the U.S. and to be a U.S. resident for tax purposes if the individual was physically present in the United States for:

- 31 days during the current year, and
- $\geq$ 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
  - All the days you were present in the current year, and
  - 1/3 of the days you were present in the first year before the current year, and
  - 1/6 of the days you were present in the second year before the current year.

There are a number of ways that an individual who has a substantial presence in the U.S. may be able to mitigate his or her exposure to double tax. The individual may be able to claim foreign tax credits, the foreign earned income exclusion or the treaty exemption (discussed above as it relates to U.S. green card holders).

In addition to these mechanisms, the individual may also be able to claim a closer connection exception (which is not available to U.S. citizens or U.S. green card holders) by filing Form 8840. By filing this form, the individual protects his or her ability to claim a closer connection to Canada and indicates that he or she should not be filing a U.S. return as a U.S. resident. If this form is not filed or filed late, the individual loses his or her ability to claim the closer connection exception and may be treated as a U.S. resident who is subject to tax on his or her world-wide income.

An individual can avoid being treated as a U.S. resident when he or she has a closer connection to another country if:

- The individual was present in the United States for fewer than 183 days in the current year,
- The individual can establish that he or she had a tax home in a foreign country, and
- The individual can establish that he or she had a closer connection to one foreign country in which he or she had a "tax home" than to the United States.

A "tax home" is an individual's main place of business, employment, or post of duty regardless of where the individual maintains his or her family home. If an individual does not have a regular or main place of business because of the nature of his or her work, then the individual's "tax home" is the place where he or she regularly lives.

U.S. Gift Tax

Canadian residents who are not U.S. citizens or domiciled in the U.S. are considered non-resident aliens for gift tax purposes and are subject to U.S. gift tax only on gifts of their interest in real or tangible property (includes U.S. real estate and tangible personal property such as automobiles, boats, etc.) situated in the U.S. Generally gifts of intangible property (like U.S. stock) made by a non-resident alien, regardless of the location of the property, are not subject to U.S. gift tax.

Like citizens and residents, a non-resident alien donor may claim an annual gift tax exclusion amount for a gift made to a spouse who is not a U.S. citizen or to other individuals. Gift tax will not apply to gifts made to a spouse who is a U.S. citizen. The lifetime gift and estate tax exclusion amount that is available to U.S. citizens and residents is not available to non-resident aliens for gift tax purposes. So a gift of U.S. real estate or tangible personal property located in the U.S. to a non-spouse recipient could result in U.S. gift tax if the value of the gift surpasses the exclusion amount ($15,000 USD in 2020).

The Canada-U.S. Tax Treaty does not cover gift tax which means that a foreign tax credit to offset Canadian tax payable on the disposition of a property that is gifted cannot be claimed for U.S. gift tax paid. The gift may still result in a deemed disposition at fair market value for Canadian tax purposes and any unrealized gains would be triggered but the tax payable cannot be offset by claiming a foreign tax credit for the U.S. gift tax. Generally speaking, Canadian residents who are not U.S. citizens or resident aliens should not make a significant gift of U.S. tangible property as such gifts could result in double tax. In that case, it may be better to simply sell the asset, triggering the gain on both sides of the border and then to give cash instead.

U.S. Estate Tax

Canadian residents who are not U.S. citizens or domiciled in the U.S. are considered non-resident aliens for estate tax purposes and are subject to estate tax to the extent that they own U.S. situs property on death.

For a Canadian resident who is not a U.S. citizen or resident alien, U.S. situs property includes:

- U.S. real estate (real property including real estate and time shares);

- Tangible property located in the U.S. (including household goods, automobiles, furnishings);
- U.S. securities including those held in a brokerage account in Canada or outside Canada;
- U.S. mutual funds including money market funds;
- U.S. pension plans;
- Interests in certain trusts including RRSPs, RRIFs, RESPs or TFSAs; and
- Any business-related assets owned and used in the U.S.

For a non-resident alien, the following categories of assets are not included in U.S. situs property and are not subject to U.S. estate tax:

- Canadian mutual funds investing in U.S. equities;
- U.S. bank accounts and term deposits (unless connected with a U.S. business);
- Publicly traded U.S. bonds and U.S. Treasury Bills; and
- Life insurance proceeds where the policy owner/life insured is a neither a resident nor a citizen of the U.S.

The value of any non-recourse debt (an obligation that is only enforceable against the property pledged as security) can be deducted from the value of U.S. property in determining the client's exposure to U.S. estate tax.

The Canada-U.S. Tax Treaty (Article XXIX-B.2) provides a number of mechanisms for a Canadian resident who is not a U.S. citizen or resident alien to mitigate exposure to U.S. estate tax including:

The Unified Estate Tax Credit

Pursuant to the treaty, a Canadian resident who is a non-resident alien of the U.S. can claim a pro-rated portion of the unified estate tax credit available to U.S. citizens or resident aliens.

The unified estate tax credit available for a non-resident alien is equal to the greater of:

a. $13,000

or

b. $\dfrac{\text{Value (USD) of gross estate situated in the U.S.}}{\text{Value (USD) of total worldwide gross estate}}$ * Unified Estate Tax Credit

In 2020, the full unified estate tax credit is $4,577,800.

Under the Canada-U.S. Tax Treaty, a Canadian resident who is not a U.S. citizen or resident alien will have an exclusion amount equal to the greater of $60,000 USD and a pro-rated portion of the unified estate credit available to a U.S. citizen determined by dividing the individual’s gross estate situated in the U.S. by the individual’s gross estate wherever situated in the world. The application of the unified estate tax credit determines the portion of the estate excluded from U.S. estate tax.

Under this formula, a Canadian resident who is not a U.S. citizen or resident alien should not have U.S. estate tax exposure if:

1. At the time of death, the value of the U.S. situs property did not exceed $60,000 USD and
2. At the time of death their worldwide estate has a value less than the lifetime gift and estate tax exclusion amount for that year.

The executor must file a U.S. Estate Tax Return for Non-Residents (Form 706-NA) if at the date of death the value of the deceased’s U.S. situs property located in the United States exceeds $60,000 USD. This return must be filed even if no estate tax is payable. Form 706-NA must be filed within 9 months of the date of death. The executor may become personally liable for a failure to pay U.S. estate tax.

EXAMPLE 1

Jane is a single Canadian resident who is not a U.S. taxpayer. Jane dies in 2020. At the time of death, the value of her gross estate situated in the U.S. was $1 Million USD, and the value of her total worldwide gross estate was $5 Million USD. Thus, her exclusion amount = $1 Million/$5 Million * $4,577,800= $915,560. As the exclusion amount is greater than the estate tax of $345,800 that would be charged on her gross estate (estate tax on U.S. situs assets of $1 Million) situated in the U.S., the estate does not have any U.S. estate tax exposure, although the executor will still need to file a Form 706-NA within 9 months after the date of death because the value of the U.S. situs property Jane held at death is in excess of $60,000 USD.

EXAMPLE 2

Mike is a single Canadian resident who is not a U.S. taxpayer. Mike dies in 2020. At the time of death, the value of his gross estate situated in the U.S. was $1.5 million (USD), and the value of his total worldwide gross estate was $13 million (USD).

Estate tax on first $1,000,000	= $345,800
Estate tax on next $500,000 x 40%	= $200,000
	$545,800

As a non-resident alien, Mike can claim a prorated unified credit which is calculated as follows:

$$\frac{\$1{,}500{,}000}{\$13{,}000{,}000} \times \$4{,}577{,}800 \text{ (2020 amount)} = \$528{,}208$$

Thus, Mike's estate will be subject to net U.S. estate tax on his death = $545,800 - $528,208= $17,592 USD. Mike's executor will need to file a Form 706-NA within 9 months after the date of death and make the payment for U.S. estate tax.

The Marital Estate Tax Credit

Another relieving provision found under the Canada-U.S. Tax Treaty that is available to Canadian residents is the non-refundable additional marital credit when assets are transferred to a surviving Canadian spouse. The additional marital credit equals the lesser of the unified estate tax credit and the amount of the estate tax otherwise payable. The marital credit is only available when the spouse is someone the deceased was legally married to – common law partners may not qualify for this credit. Effectively, this allows for a U.S. citizen to transfer $23.08 Million USD in assets to a non-U.S. citizen spouse directly or indirectly to a spousal trust.

Figure 6.1: Marital Credit Available?

IS DECEASED A U.S. CITIZEN?	SURVIVING SPOUSE U.S. Citizen	SURVIVING SPOUSE Not a U.S. Citizen
YES	NO; as the unlimited marital deduction is provided for under U.S. Domestic Law	YES can elect to claim marital credit in addition to the unified credit
NO	NO; as the unlimited marital deduction is provided for under U.S. Domestic Law	YES can elect to claim marital credit in addition to the pro-rata unified credit

Unlimited Marital Deduction

Normally the unlimited marital deduction is only available when the surviving spouse is a U.S. citizen. The estate of a Canadian resident also has the option to claim an unlimited marital deduction in lieu of the marital credit pursuant to the Canada-US Treaty. In order to claim the unlimited marital deduction, the value of the assets in excess of the U.S. estate tax exemption must be transferred to a Qualified Domestic Trust for the benefit of the non-U.S. citizen spouse. A Qualified Domestic Trust (commonly referred to as a “Q-DOT’) is a special kind of trust that is set up either by will or by the executor within 9 months following the death of the first to die to allow for the transfer of the deceased’s assets to the surviving spouse. Effectively the U.S. estate tax is deferred on the assets left to the non-U.S. citizen spouse.

The estate has either the option to claim the marital credit or the unlimited marital deduction with the Q-DOT but not both. The will should provide the executor with the flexibility to choose which option is best. If the U.S.

estate tax liability cannot be sheltered by claiming the unified tax credit and the marital credit, then the estate may wish to defer the U.S. estate tax by claiming the unlimited marital deduction.

Figure 6.2: Unlimited Marital Deduction Available?

IS DECEASED A U.S. CITIZEN?	SURVIVING SPOUSE U.S. Citizen	SURVIVING SPOUSE Not a U.S. Citizen
YES	YES; Q-DOT not required	NO; unless waive marital credit under the Canada/U.S. Treaty and use Q-DOT
NO	YES; Q-DOT not required	NO; unless waive marital credit under the Canada/U.S. Treaty and use Q-DOT

The Foreign Tax Credit

The Canada-U.S. Treaty provides some relief from U.S. estate tax in that the U.S. estate tax paid on death may be eligible as a foreign tax credit that offsets Canadian taxes payable in the year of death.

On death, a Canadian resident will pay tax on the accrued gain of a U.S. asset because of the deemed disposition that takes place at death for Canadian tax purposes. The Canadian resident may also be subject to U.S. estate tax. Because U.S. estate tax rates are higher than the Canadian rates on capital gains, it may be possible to offset all of the Canadian tax payable by claiming a foreign tax credit. Ultimately, the individual will pay tax at the higher rate between the two jurisdictions.

Relief for Small Estates

The Canada-U.S. Tax Treaty provides some relief from U.S. estate tax for small estates worth less than $1.2 Million USD. This relief will not apply when the Canadian taxpayer's estate includes U.S. real property or an interest in a U.S. partnership or U.S. corporation that holds real property in the U.S.

Donating U.S. Situs Property to a U.S. Charity

If the U.S. situs property is donated to a U.S. charity, the U.S. estate tax on the asset will be avoided.

It is important to note that in order to claim the benefits of the Canada-US tax treaty, a U.S. estate tax return must be filed on behalf of the deceased. Even if the estate will have no U.S. estate tax liability it is therefore very important that the return is filed.

The Canada-U.S. Treaty Applies Differently to U.S. Citizens Resident in Canada from Other Canadians

Canadian residents who are not U.S. citizens may benefit from the relieving provisions of the tax treaty between Canada and the U.S., whereas U.S. citizens who live in Canada may not benefit in all cases, as the treaty applies to them quite differently. Generally, U.S. citizens living in Canada benefit from the treaty relief as it relates to Canadian tax, but not as it relates to U.S. tax.

For example, U.S. citizens are not entitled to the pro-rated unified estate tax credit under the Canada-U.S. Tax Treaty, because they are already entitled, under U.S. domestic law, to 100% of the unified credit without any reduction.

Different U.S. Estate Tax Rules for Canadians Who Are Not U.S. Citizens from Those Who Are

Many of the U.S. rules that apply to U.S. citizens resident in Canada do not apply to Canadians who are non-resident aliens.

For example, under the new rules introduced in 2010, the unused unified estate tax credit on the death of the first spouse is “portable” to the estate of the last spouse to die in certain circumstances. Essentially this allows the deceased’s unused gift or estate tax exemption to be transferred to the surviving spouse. An election must be made on the U.S. estate tax return that is filed for the first to die. These portability provisions are not available unless both spouses are U.S. citizens.

Different U.S. Gift Tax Rules for Canadians Who Are Not U.S. Citizens from Those Who Are

U.S. gift tax differs for Canadians depending on whether they are U.S. citizens or not, and whether they are married to another Canadian who is a U.S. citizen or a non-resident alien of the U.S.

U.S. citizens are subject to U.S. gift tax on gifts made during their lifetime regardless of where the assets are located. However, there are some exceptions:

- A U.S. citizen can make unlimited gifts to a U.S. spouse
- A U.S. citizen can exclude the first $15,000 USD of annual gifts per done with no limit on the total number of recipients.
- A U.S. citizen can exclude the first $157,000 USD of annual gifts to a non-U.S. spouse (recipient spouse is a non-resident alien of the U.S.)

- A U.S. citizen wherever resident may use his or her unified estate tax credit during his or her lifetime to shelter the annual gifts made in excess of the annual gift tax exclusion amount.

Canadians who are not U.S. citizens or U.S. residents are only subject to U.S. gift tax on U.S. situs property. "U.S. situs property" subject to gift tax differs from "U.S. situs property" for the purposes of U.S. estate tax in that intangible property is excluded for gift tax. This means, for example, that U.S. stocks and bonds are not subject to U.S. gift tax.

Canadians who are not U.S. citizens or U.S. residents however cannot offset the excess value of the gift with the lifetime gift and estate tax exemption (unified estate tax credit).

The following table illustrates these differences:

Figure 6.3: Will U.S. Gift Tax Apply?

IS DONOR A U.S. CITIZEN?	RECIPIENT SPOUSE U.S. Citizen	RECIPIENT SPOUSE Not a U.S. Citizen	RECIPIENT OTHER U.S. Citizen	RECIPIENT OTHER Not a U.S. Citizen
YES	NO GIFT TAX: unlimited gift tax marital deduction available.	YES: On gifts of all property exceeding the annual exclusion ($157,000 for 2020). May apply Unified Estate Tax Credit.	YES: On gifts of all property exceeding the annual exclusion ($15,000 in 2020). May apply Unified Estate Tax Credit.	YES: On gifts of all property exceeding the annual exclusion ($15,000 in 2020). May apply Unified Estate Tax Credit.

NO	NO GIFT TAX: unlimited gift tax marital deduction available.	Only on U.S. real and tangible personal property exceeding the annual limitation ($157,000 in 2020). No Unified Estate Tax Credit available.	Only on U.S. real and tangible personal property exceeding the annual limitation ($15,000 in 2020). No Unified Estate Tax Credit available.	Only on U.S. real and tangible personal property exceeding the annual limitation ($15,000 in 2020). No Unified Estate Tax Credit available.

U.S. Estate Tax Planning for Residents of Canada who are Not U.S. Citizens

A number of strategies are available to reduce U.S. estate tax for residents of Canada.

A U.S. professional should be consulted regarding any tax planning strategies to reduce U.S. estate tax. The U.S. gift tax rules, Canadian and U.S. income tax rules, the effect of the Canada-U.S. Tax Treaty, and the estate planning objectives of the taxpayer must all be considered before commencing any U.S. estate planning implementation. This typically requires input from both U.S. and Canadian advisors, ideally all of whom specialize in cross-border planning.

Please also note that the tax laws on both sides of the border are subject to change and as those changes are made, the existing estate plan may need to be revisited and adjusted.

There are also planning techniques available to U.S. citizens who are resident in Canada. However, these are not specifically included here.

Make Lifetime Gifts of U.S. situs property

If the value of U.S situs property is reduced, so is the potential U.S. estate tax liability upon death. Gifts of U.S. situs property may be made annually to any recipient with a value not exceeding the annual gift tax exclusion amount ($15,000 USD for 2020 or $157,000 USD to a non-U.S. spouse). Making annual gifts below the exclusion amount for the given year may help reduce exposure to U.S. estate tax on death. Over time a substantial reduction of U.S. property can be made in this manner as the limit is per recipient and both a husband and wife may make such gifts (i.e., $30,000 U.S. can be given by a couple to each recipient in 2020).

There are a few things to consider in using this annual gifting strategy:

- For Canadian purposes, a donor who gifts an asset is deemed to dispose of it at its fair market value and any unrealized gain or loss is triggered at the time of the gift. A gift to a spouse generally results in a spousal rollover but the attribution rules will apply.
- For US tax purposes, the donor is not deemed to dispose of the gift at fair market value and the recipient will receive the gift with a cost base equal to that of the donor. When the recipient disposes of the asset, the cost base for US tax purposes can result in a mismatch in the timing of the gain on both sides of the border. This mismatch may be eliminated by filing an election under the Canada-US tax treaty that forces the recognition of the gain in the U.S. at the time of the gift.
- Significant gifts in excess of these annual amounts should be avoided as U.S. gift tax will then apply and this tax cannot be claimed as a foreign tax credit for Canadian tax purposes.
- Keep in mind that property gifted to a spouse may still be subject to U.S. estate tax on the death of that spouse.

EXAMPLE 1

A father gifts a U.S. situs property with a fair market value of $500,000 USD and a cost base of $300,000 USD to his son. Let's assume that 1 USD = 1 CAD. Father and son are not U.S. citizens or U.S. green card holders and do not have a substantial presence in the U.S.

For Canadian tax purposes, the father is deemed to have sold this property for $500,000 and realizes a capital gain of $200,000. The son receives the property with a cost base equal to $500,000.

The U.S. does not treat the gift as a disposition, so the unrealized gain is not triggered in the U.S. The gift is subject to U.S. gift tax in the U.S. as the value of the gift is in excess of the annual exclusion amount for the year ($15,000 USD in 2020). This U.S. gift tax cannot be recovered by claiming a foreign tax credit against the Canadian tax paid on the gain.

Continuing with the example above, the entire unrealized capital gain of $200,000 will be taxed when the son disposes of the property.

Relief pursuant to the Canada-US tax treaty may be sought by filing an election that forces the recognition of the gain in the U.S. at the time of the gift so that the double tax is avoided.

EXAMPLE 2

Mr. A gifts a U.S. situs property with a fair market value of $500,000 USD and a cost base of $300,000 USD to his spouse, Mrs. A. Let's assume that 1 USD = 1 CAD. Both spouses are not U.S. citizens or U.S. green card holders and do not have a substantial presence in the U.S.

For Canadian tax purposes, the property transfers at cost to the other spouse. The attribution rules will apply and the gain that is realized when the transferee disposes the property will be attributed back to the transferor.

The gift is subject to U.S. gift tax in the U.S. as the value of the gift is in excess of the annual exclusion amount for the year ($157,000 USD in 2020). This U.S. gift tax cannot be recovered by claiming a foreign tax credit on the Canadian return for Mr. A.

When Mrs. A sells the property, the gain will be taxed in her hands but for Canadian tax purposes, the gain will attribute back to Mr. A. There is no ability to claim a foreign tax credit against the Canadian tax payable on the gain because the U.S. tax was paid by Mrs. A not Mr. A. The gift results in a mismatch on both sides of the border that creates double tax.

Gift by Will of U.S. situs property to a U.S. Charity

U.S. situs property donated on death to a qualified U.S.. charity will be deducted from both the U.S. situs property and the U.S. taxable estate. Such planning must be implemented carefully as the donation tax credit for Canadian income tax purposes may only be eligible to be claimed against U.S. sourced income.

Hold U.S. Securities in a Canadian Corporation

The shares of a Canadian corporation holding U.S. securities will not be considered U.S. situs property. Caution should be exercised if an existing U.S. portfolio is transferred into a Canadian corporation for the sole purpose of U.S. estate tax avoidance, as a U.S. anti-avoidance rule may apply.

Hold U.S. Investments through Canadian Mutual Funds

Generally Canadian mutual funds will not be considered U.S. situs property even if the fund invests in U.S. securities.

Taking Full Advantage of the Unified Credit as Between Husband and Wife

Canadian individuals are entitled to a portion of the unified estate tax credit. Where possible a husband and wife can hold property to maximise the use of the available credit on the death of each spouse. This, combined with the use of spousal trusts (see below at 6.4.6), can significantly reduce the exposure to U.S. estate tax of a married couple.

Note that special rules apply to property that is jointly held with a right to survivorship. Generally for U.S. estate tax planning purposes it is better not to hold property jointly with a right of survivorship because the full value of the property will still be subject to U.S. estate tax unless evidence is provided that the survivor paid for his or her share of the jointly held asset with his or her own funds.

Transferring U.S. situs property from one spouse to another to implement this strategy may attract U.S. gift tax (except for intangible U.S. situs property), or could result in a mismatch later between the U.S. tax payable and Canadian tax payable as a result of the attribution rules. On the sale of the property or on death, U.S. tax will be a liability of the owner (the recipient), whereas Canadian tax will be a liability of the other spouse (the original owner). As a result, there is a mismatch and no foreign tax credit will be available to offset the Canadian tax payable on the gain.

Use Spousal Trusts in Both Wills of Husband and Wife

The use of “criss-cross” spousal trusts in both wills of a husband and wife, where each provides for a spousal trust for the benefit of the surviving spouse, may reduce the potential U.S. estate tax on the death of the surviving spouse although these must be properly structured to achieve the U.S. objectives. In addition, such trusts are usually designed to benefit from the spousal rollover under Canadian rules. The spousal trust can reduce the U.S. taxable estate of the surviving spouse because assets in the spousal trust are not included in the surviving spouse's estate for U.S. estate tax purposes. U.S. investments could be used to fund such a trust and this would have the result of significantly reducing U.S. estate tax on the death of the survivor. A restriction on discretion to distribute capital, other than realized capital gains, from the trust to the surviving spouse may be necessary in order to ensure the trust assets are excluded from the estate of the surviving spouse for U.S. purposes. In some cases the right to encroach on capital must be subject to what are referred to as "hems" purposes. "Hems" stands for health, education, maintenance, and support. The U.S. rules are very strict in this area, and U.S. counsel must review the wills.

In order to use this strategy, assets must be held separately as between husband and wife (and not jointly with a right of survivorship) so they will form part of the estate of the first to die. The trust can be a qualifying spousal trust for Canadian tax purposes so that the rollover is available if during lifetime of the surviving spouse all net income is payable to the surviving spouse and no one other than the surviving spouse is entitled to the capital of the trust.

Use a Qualified Domestic Trust for Assets Passing to a Surviving Spouse

Where assets are bequeathed to a Q-DOT, a non-resident alien of the U.S. can use the marital deduction in lieu of the marital credit to eliminate U.S. estate tax on assets passing to the Q-DOT on the first death. However, this strategy results in a tax deferral rather than a tax saving as all assets in the trust will be taxed either on distribution during lifetime of the surviving spouse or on the death of the surviving spouse. U.S. rules set out the terms for a spousal trust to qualify as a Q-DOT. Among other requirements, the trust must have a U.S. trustee.

Life Insurance

Life insurance can be used to fund the U.S. estate tax liability in appropriate circumstances. Life insurance issued on the life of the Canadian individual will not be U.S. property even if the policy is issued by a U.S. entity. Life insurance proceeds are included in the deceased's world-wide estate and can reduce the tax credits available under the provisions of the Canada-US Tax Treaty. However, the value of the death benefit can be excluded from the world-wide estate if the deceased did not own the policy. For this reason, it may be advantageous to transfer ownership of the life insurance to a trust or other person to avoid reducing the amount of estate unified credit and marital credit. Planning in this regard should be undertaken well in advance of death as transfers made within 3 years of the date of death may not achieve the desired result.

Summary of Key Issues

The impact of non-Canadian tax and succession law on Canadians must be appreciated by any advisor providing tax or estate planning advice. This study unit attempts to ensure that the advisor will be aware of situations where laws of other jurisdictions may apply. However, foreign planning should be left to those who specialize in such areas of expertise, including professionals from other jurisdictions.

Key indicators that may indicate further investigation include the following:

- Beneficiaries who are non-residents
- Executors who are non-residents

- Assets held that are situated in another country, especially immovable property (such as real property) and property in civil law jurisdictions, and
- Citizenship outside Canada especially in civil law jurisdictions
- U.S. green card holders

Terminology

Annual Gift Tax Exclusion Amount: The amount that can be gifted annually to any particular recipient, without attracting U.S. gift tax.

Lifetime Gift and Estate Tax Exemption Amount: The Lifetime Gift and Estate Tax Exemption Amount is the value of an estate that will not be subject to U.S. estate tax. The exemption amount is also the basis for calculating the unified credit. The unified estate tax credit, whether the full amount which is available to U.S. persons or the pro-rated amount which is available to non-resident aliens, will always offset all the U.S. estate tax on an estate with a worldwide value equal to or less than the Lifetime Gift and Estate Tax Exemption Amount in the year of death. The amount is subject to change.

Marital Deduction: The marital deduction is available under U.S. domestic law for the first to die of a married couple where both are U.S. Citizens or other persons taxed as U.S. taxpayers including U.S. citizens or U.S. green card holders. The deduction defers the U.S. estate tax on any amount left to the surviving spouse or certain spousal trusts, until the death of the surviving spouse. Married Canadians who are both non-resident aliens may only benefit from the marital deduction if the property is left for the benefit of the surviving spouse in a Q-DOT and no marital credit relief is claimed.

Non-Resident Alien: This refers to a person who is not a citizen of the U.S., or who is not otherwise a U.S. taxpayer. Under U.S. gift and estate tax law residency is based on where an individual is "domiciled". The concept of "domicile" is different than residency for income tax purposes. A non-resident alien for gift and estate tax purposes is not 1) a U.S. citizen or 2) U.S. green card holder or foreign person who is "domiciled" in the U.S.

Resident Alien: For U.S. income tax purposes this includes a U.S. green card holder or a foreign person who meets the substantial presence test but who has not claimed a closer connection exception (not available for U.S. green card holders) or a treaty exemption. For gift and estate tax purposes, this includes U.S. green card holders and foreign persons who are "domiciled" in the U.S.

Unified Estate Tax Credit: The amount of the U.S. estate tax that can be sheltered by the Lifetime Gift and Estate Tax Exemption Amount. A U.S. citizen or resident alien will be able to claim the full amount but a non-resident alien is entitled to a pro-rated amount based on the proportion of the value of the deceased's estate which represents U.S. situs property.

U.S. Citizen: An individual who has U.S. citizenship. A person born in the U.S. or a person who is born to U.S. parent in a foreign country may have U.S. citizenship depending on what year they were born and how much time their U.S. citizen parent spent living in the U.S. before he or she turned 18

U.S. Taxpayer: U.S. taxpayers include U.S. citizens or U.S. resident aliens for U.S. income tax purposes.

U.S. Situs Property: For the purposes of the U.S. rules this is property that is subject to U.S. estate tax for persons who are non-resident aliens of the U.S. Certain intangible U.S. property is U.S. property for the purposes of U.S. estate tax, but not for the purposes of U.S. gift tax.

Review Questions and Answers

Questions

1. True or False:

   For the purposes of U.S. estate tax, world-wide property includes:

   a. The death benefit from life insurance held by the deceased, where the deceased was the insured, regardless of who is named as beneficiary

   b. The full value of a registered plan owned by the deceased at death.

   c. The value of the U.S. condominium that was transferred to the deceased's children prior to his death.

   d. 50% of the value of jointly held property between the deceased and his or her spouse.

2. True or False:

   a. A U.S. citizen is generally subject to U.S. estate tax on his or her world-wide estate but this will not apply if the U.S. citizen moves to Canada and applies for Canadian Citizenship.

   b. U.S. estate tax may be payable if the world-wide estate of a Canadian exceeds the value of $11,580,000 and the individual died in 2020.

   c. As long as no U.S. estate tax is payable and the value of the estate does not exceed the Lifetime Gift and Estate Tax Exemption, then no U.S. estate tax return has to be filed.

   d. The amount of the unified estate tax credit available to a non-resident alien to reduce U.S. estate tax payable depends on the year of death, the cost of the U.S. property owned at death and the proportion of the value of the estate that constitutes U.S. situs property.

e. Income tax can be avoided by placing assets received from a foreign person in a foreign trust.

f. Canadian residents are required to report on an annual basis the ownership of foreign property where the total fair market value of the foreign property exceeds $100,000.

g. Canadian residents are required to report on an annual basis the ownership of vacation properties located in foreign jurisdictions that are exclusively used for personal use.

h. U.S. Green card holders who reside in Canada and do not own property in the U.S. and who have no intention to move back to the U.S. will still be subject to U.S. estate tax on their world-wide estate.

3. U.S. estate tax rules are not the same for U.S. citizens who are resident in Canada and Canadian residents who are non-resident aliens of the U.S. List four (4) differences.

4. Explain how reducing the value of the world-wide estate by making lifetime gifts of property might reduce or eliminate exposure to U.S. estate tax on the death of a Canadian resident who is a non-resident alien of the U.S. Give explanations for gifts of both U.S. situs property and other property. What dangers lie in making life-time gifts of U.S. property for Canadian residents who are non-resident aliens of the U.S.?

5. What is the difference between U.S. gift tax and U.S. estate tax rules as they apply to U.S. securities held by a Canadian resident who is a non-resident alien of the U.S.?

6. Compare the U.S. estate tax treatment of shares of a U.S. holding corporation to shares of a Canadian holding corporation, assuming they are held on death by a non-resident alien of the U.S.? How would your answer differ if the deceased were a U.S. Citizen?

7. Graham died in 2020 with a world-wide estate of $8,000,000 USD. Graham is a single Canadian resident (not a U.S. Citizen or U.S. Green card holder) and has a condominium located in Hawaii worth $1,500,000 USD.

   a. What is Graham’s possible exposure to U.S. estate tax?

   b. If the maximum unified estate tax credit for 2020 was $4,577,800 for U.S. citizens, what was Graham’s U.S. net estate tax payable?

   c. Would your answer be different if Graham was married and left the condo to his wife who is a U.S. citizen resident in Canada?

8. Paula and George each hold assets in their own names worth $10,000,000 and $4,000,000 respectively. Paula’s assets include a portfolio of U.S. stocks worth $2,000,000. Paula understands that at least for 2020, she need do no U.S. estate tax planning.

   a. What comments might you make about her understanding?

   b. What planning ideas might you suggest to her and George?

Answers

1. True or False:

   a. True. The value of the life insurance owned by the deceased would be included in the value of the world-wide estate.

   b. True. The value of the registered plan would form part of the world-wide estate.

   c. False. The value of the U.S. condo would not form part of the estate but the transfer to the children may have been subject to U.S. gift tax.

   d. False. U.S. situs property that is held jointly with a right of survivorship is fully included unless the taxpayer can provide evidence that the joint owners contributed jointly to the account or to purchase the property.

2. True or False:

   a. False. A U.S. Citizen wherever resident is subject to U.S. estate tax on his world-wide estate. Applying for citizenship in a foreign country will not affect this exposure. The only way a U.S. citizen can eliminate this exposure is by renouncing his U.S. citizenship.

   b. True. An estate that does not have a value that exceeds the Lifetime Gift and Estate Tax Exemption will not be subject to U.S. estate tax.

   c. False. Even if no U.S. tax is payable, a U.S. estate tax return is required to be filed if the value of the U.S. situs property exceeds $60,000 USD.

   d. False. The amount of the unified credit to reduce U.S. estate tax payable depends on the year of death, the value of the U.S.

property owned at death and the proportion of the value of the estate that constitutes U.S. situs property.

e. False. Special complex provisions exist where a foreign trust may still be subject to Canadian income tax on its world-wide income.

f. False. Canadian residents are required to report on an annual basis the ownership of foreign property on a T1135 Foreign Income Verification Statement where the aggregate cost of the foreign property exceeds $100,000.

g. False. Vacation properties that are exclusively used personally are not required to be reported on the T1135 Foreign Income Verification Statement

h. True. U.S. Green card holders who are not domiciled in the U.S. are not subject to U.S. estate tax.

3. Four differences between the application of U.S. estate tax to Canadian residents who are non-resident alien of the U.S. and Canadian residents who are U.S. Citizens.

a. U.S. citizens are taxed on the value of their assets held worldwide whereas Canadian non-resident aliens are taxed only on U.S. situs property.

b. U.S. citizens are entitled to the full amount of the maximum unified estate tax credit for the year of death, whereas Canadian non-resident aliens are only entitled to a pro-rated portion of the unified estate tax credit.

c. U.S. citizens can always completely defer U.S. estate tax on all property left to a surviving spouse or certain spousal trusts by using the marital deduction but Canadian non-resident aliens are only entitled to the marital deduction in limited circumstances (only on property passing to a Q-DOT and where the estate waives the marital credit otherwise available under the treaty).

d. U.S. Citizens are not entitled to the marital credit under the Canada-US Tax Treaty which only Canadian non-resident aliens can use.

4. Gifts of any property will reduce the world-wide estate. If the value of the world estate is below the Lifetime Gift and Estate Tax Exemption Amount for the year of death, no U.S. estate tax will be payable. Reducing the value of the world-wide estate will also increase the amount of pro-rated unified credit available.

   Gifts of U.S. situs property in excess of the annual exclusion amount are subject to U.S. gift tax (ranging from 18% to 40%) and must be reported on a U.S. gift tax return.

   The two main issues to be aware of are:

   - The U.S. gift tax cannot be claimed as a foreign tax credit
   - The gain may be recognized at different times potentially resulting in double taxation unless an election under the Canada-US Tax treaty is available.

5. U.S. gift tax does not apply to gifts of intangible U.S. property like U.S. securities, but U.S. estate tax does.

6. For a non-resident alien of the U.S. shares of a U.S. corporation are considered part of her world-wide estate and subject to U.S. estate tax, whereas the shares of a Canadian corporation are not.

   For a U.S. citizen, both shares of a U.S. corporation or shares of a Canadian corporation would be subject to U.S. estate tax as a U.S. citizen is subject to U.S. estate tax on all property held on death wherever situated.

7. Graham

   a. Possible estate tax exposure for U.S. condo

On the first $1,000,000	$345,800
On the remaining $500,000 (at 40%)	$200,000
Tentative Tax	$545,800

   b. Prorated Unified Estate Tax Credit

   1,500,000 / 8,000,000 = 18.75% x $4,577,800 = $858,338

   Graham will not be subject to U.S. estate tax in 2020.

   c. Yes. No estate tax would be payable because of the marital deduction available when assets are transferred to a U.S. spouse that permits the deferral of U.S. estate tax until the death of the surviving spouse.

8. Paula and George

   a. Paula may have no U.S. estate tax if she dies in 2020 because her world estate has a value of less than $11,580,000 USD. However, she or George could be exposed to U.S. estate tax on the death of the surviving spouse if they are leaving all or a portion of their estates to each other. For example, if she and George both die one month apart in in 2020, the value of the estate of the surviving spouse will include the property inherited from the other, possibly causing the value of the estate of the second to die to exceed the Lifetime Gift and Estate Tax Exemption.

   b. Giving U.S. estate tax advice if you are not an expert is dangerous. You might advise Paula and George to seek U.S. advice from a professional who has this expertise or work with such an advisor on their behalf.

   Some possible planning ideas (only to be confirmed by a U.S. tax advisor) might include:

i. Moving her U.S. portfolio to a Canadian holding corporation. Advice should be obtained regarding the potential application of U.S. anti-avoidance rules. These might dictate a requirement that there be other planning objectives motivating the incorporation of the portfolio, such as probate taxes, or other estate planning.

ii. Using a spousal trust for George in her Will with terms that result in the property being subject to the Canadian spousal rollover rules, as well as being excluded from the estate of the surviving spouse for U.S. estate tax purposes. This requires special structuring and U.S. advice is essential. If George has no U.S. property, this will provide complete relief if Paula dies first. However, if George dies first and Paula is a beneficiary of his estate, Paula's estate may exceed the Lifetime Gift and Estate Tax Exemption and the U.S. portfolio will be subject to U.S. estate tax. To avoid this result, George should also create a spousal trust for Paula to keep her estate below the Exemption Amount for 2020.

Unit Seven: Case Studies

Case Study Scenarios

Case Study 1: The Greenback's Estate Plan

Penny and Nicholas Greenback, age 65 and 67, have three children, Loonie, Toonie, and Bill.

Bill suffers from Downs Syndrome and has been in a group home since he was 16. He is now 36 and is single with no children.

Loonie, age 41, is the oldest daughter. She is married with three children and has a busy career as a marketing executive. Her husband Jack is a chartered accountant with a large international public company, and he travels frequently both within Canada and throughout Europe and the U.S.

Toonie, the youngest daughter, age 33, has had two failed marriages and is currently living common law with Bert. She has one son Sam from a previous marriage, and she and Bert have one daughter together.

Toonie is very bright but never achieved academic success like her sister. Her parents are currently funding her educational expenses and daycare costs so she can complete her training and qualify as a registered nurse.

Penny and Nicholas' assets are as follows:

Asset	Penny	Nicholas	Joint with right of survivorship or last to die	Designation
Residence			$425,000	
Bank Accounts	$10,000		$35,000	
Life Insurance	$125,000	$300,000		None
Joint last to die Life Insurance			$200,000	None
Registered Plans	$230,000	$35,000		Spouse
Registered Plans	$68,000			Spouse
Investment Accounts	$640,000	$800,000		
Cottage (in Ontario)			$185,000 with Loonie	
TFSA	$11,500	$20,500		Spouse

Penny and Nicholas have Wills and Powers of Attorney for Property and Health Care Directives. Their Wills are "mirror Wills" leaving everything to each other providing the spouse survives by 30 days, with a gift over to their issue in equal shares *per stirpes*. The executor is the surviving spouse, with Penny's brother, Dime, as alternate executor.

Assume Penny and Nicholas wish to review their estate plan with you. Prepare a list of questions to obtain missing information that would be relevant to their estate plan.

Explain why these questions are important and how the estate plan might be designed – i.e., what strategies might be appropriate, depending on their answers.

Case Study 2: The Greenback's Estates

Penny and Nicholas were killed in a car crash before any new Wills could be executed or any changes could be made (except as noted below with respect to the beneficiary designation of one of Penny's RRSPs). Nicholas died instantly and Penny died from her injuries five weeks later in hospital. Penny's brother, Dime, and Loonie have come to see you to review the administration and distribution of Penny's and Nicholas' estate. Dime does not want to act as executor because he has just remarried and is spending six months a year at his winter home in Florida. Loonie is willing to take over as executor but is not sure what is involved and wants advice. She is concerned because Toonie is already asking when she will get her money as she and Bert are thinking about getting married and buying a house. In addition, Loonie is very pre-occupied with her recent separation from Jack and is concerned that he will be able to "cash in" on her inheritance.

1. What is required in order for Loonie to be able to administer the estate? What might you advise her, considering her reluctance to act as administrator? How might Penny and Nicholas have provided for this situation in their Wills?
2. Loonie discovers that her mother changed the beneficiary designation on the registered plan for $68,000 to Loonie. Loonie wants to know the tax consequences of receiving the proceeds. What are they?
3. Explain how the funds from the other registered plans will be paid. Assume Penny did not transfer the funds to her own plan before her death. How will they be taxed?

4. Calculate the assets subject to probate in each of Nicholas' and Penny's estates. How could the value of assets subject to probate have been reduced for Penny and Nicholas? Assume the total expenses in Nicholas' estate including funeral, legal, accounting, income tax, probate fees and executor fees are $100,000.

5. Calculate the net estate for Penny passing under her Will after all expenses (i.e., the amount available for distribution) considering your answer and the information in question 4. Assume Penny has no income from any other sources in the year, and that her effective tax rate (i.e., average tax rate) on any income in the terminal return is 50%. Assume the following:

   a. probate fees payable of 1%,

   b. funeral expenses of $10,000,

   c. real estate commission of 5% on the home,

   d. executor's fees of 5%,

   e. accounting and legal fees of $11,950,

   f. the cottage was transferred into joint names with Loonie as a true gift and passes outside Penny's estate by right of survivorship. The principal residence exemption is used on the main residence. Penny's cost of her interest in the cottage at the time of her death (including the portion inherited from Nicholas) was $72,500,

   g. the income tax on Nicholas' registered plan has already been paid by his estate and is included in the $100,000 expenses noted in question 4, and

   h. capital gains in the estate from investment accounts are $120,000.

6. How will Penny's estate be distributed? Considering your answer in question 5, how much will each beneficiary receive? What should the executors do before making any final distribution and why?

7. How would the distribution of the two estates be different if Loonie had died before her parents?
8. Assume there is a hotchpot clause in each of Penny's and Nicholas' Wills requiring that on the death of the surviving spouse, the executor must take into hotchpot the value of the cottage at the time of the death of the surviving spouse in calculating the share of any residual beneficiary. What would the effect of such a clause be?
9. What estate planning advice would you give to Loonie? How might she protect her inheritance from Jack?

Case Study 3: Loonie and Jack: The Next Generation

It is now 10 years after Penny and Nicholas died in Case Study 2. Loonie and Jack reconciled and are now concerned about their own estate planning. They are interested in maximizing any tax planning and tax saving opportunities. While they are comfortable in their marriage, they have kept their assets separate over the years with the exception of the family home which is in joint names. Each of them has group insurance and defined contribution pension plans, but no RRSPs.

Loonie still owns the cottage in her own name and it has appreciated since she inherited it, as it is now worth $600,000.

Jack has an illegitimate son from an affair he had while separated from Loonie. He makes voluntary support payments but has no contact with the child or his mother. Jack and Loonie's three children are all in their 20s. One is married and planning to have a family and the other two are still pursuing their post-secondary educations. All of them have good career expectations.

After discussions with Jack and Loonie you have also discovered a number of factors that will impact their estate plan.

- Jack wants to provide for his illegitimate son by continuing the support payments and funding his post-secondary educational expenses until age 25.
- Both Jack and Loonie are concerned about preserving the inheritance for their children in the event one of them dies and the other remarries.
- Jack and Loonie are concerned about the potential claims that could be made by a son- or daughter-in-law against their children's inheritance.

1. Loonie is concerned about the lakefront cottage. She wants to know how it will be taxed if she sells it now or holds it until death. She has owned it for 10 years – from 2010 until 2020. She and Jack used their principal residence exemption for the years 2010 to 2014 on a previous home. Assume her tax cost of the property is $160,000. What is the minimum amount she must report if she sells the cottage for fair market value in 2020? Show how this will be reported in her return.
2. If Loonie doesn't sell the cottage now, she is also interested in considering how it can be passed to the children. The family next to her at the lake has transferred the cottage to a family trust and Loonie is interested in how that might work in her situation. Currently only two of the children ever go to the cottage on a regular basis, and the third child has no interest at all in the cottage. What would you advise her and why?
3. What might you suggest regarding Jack's wish to provide for his illegitimate son?
4. How might Jack and Loonie's estate be distributed on the first death if one of them survives? What strategies would you suggest with respect

to passing property to the children? Explain the benefits of using trusts as compared to an outright distribution.

5. Loonie is also concerned about her sister Toonie. She and Bert never married, and they now have two children of their own. Toonie also has Sam from a previous marriage. They have no Wills. Toonie has spent her inheritance from her parents, purchasing their family home, which is in joint names with Bert, and re-building a cottage on a property Bert inherited from his parents. All assets except the family home are in Bert's name. Loonie is concerned about what will happen to Toonie if Bert dies without a Will. What can you tell Loonie about Toonie's situation if Bert dies without a Will? What would you advise Loonie regarding Toonie's situation?

Case Study 4: Big Banana

Big Banana is a line of children's playwear manufactured by BB Ltd, a Canadian controlled private corporation ("CCPC") which in turn is wholly-owned by another CCPC – BB Holdco. BB Holdco is owned one third by each of Edna, Sonja and Roberto who are sisters and a brother. All the business assets are held by BB Ltd., and BB Holdco has an investment portfolio funded by dividends from BB Ltd. worth $1,500,000. The assets in BB Ltd. include "goodwill" worth $4,000,000 that is not on the balance sheet. Neither corporation has any debt. Applebaum, Banana's accountant, estimates the value of the business is approximately $8,000,000, including the off-balance sheet goodwill, but not including the investments in BB Holdco.

1. Assuming that the shares have been held for over 10 years by Edna and her siblings, and that BB Ltd. carries on an active business primarily in Canada, do the shares of BB Holdco qualify for the capital gains exemption? Why or why not? What are the tests that are

applicable? What can be done to make the shares of Holdco qualify for the exemption?

2. What reason might you speculate for the existence of BB Holdco, and the reason it has received cash dividends from BB Ltd.?

3. If corporate life insurance is to be purchased to fund a buyout on death among the shareholders, which corporation should own the policy or policies and why? Who should be the beneficiary of the policy and why?

4. The accountant for the corporations is urging Edna and her sister and brother to do an estate freeze for the benefit of their children, utilize the capital gains exemption in the course of the freeze, and permit their children future access to the capital gains exemption.

    a. What must take place before the shareholders can utilize their capital gains exemption?

    b. Which corporation should issue the new common shares in the course of the freeze? Could it be either corporation? Discuss the options relating to a freeze and a crystallization and their consequences to the siblings.

    c. Make recommendations regarding the ownership of the new common shares issued in the course of the freeze. Discuss ownership by one or more trusts, as compared to individual ownership.

Answers to Case Studies

Case Study 1: The Greenback's

Note that these are suggested questions. There may be many more or less, depending on how the Greenback's answer the first few questions. The list is not necessarily complete either. In addition, each advisor will have his or her own style as to how these issues will be raised and the nature of the advisor's practice (law, accounting, insurance, trust officer, etc.) will often dictate specific questions. Often some of these questions might be answered in a questionnaire already prepared by the client. The advisor may already be aware of some of the answers because of an existing relationship with the clients, or from a source of referral. They would not necessarily all be asked.

1. How old are their current Wills? If they are very out of date and/or there have been significant changes since the Wills were prepared, it is likely that the whole estate plan should be reviewed and planned "from scratch" rather than just considering changes to the existing plan.

2. Is it still appropriate for Dime to be the executor once they have passed away, or might they be interested in choosing another executor, possibly one or more of their children? Who would be appropriate? The choice of executor is often out of date. Siblings are commonly chosen when children are too young for the responsibility. However, as children mature, they become able to act as executor.

3. What would they like to modify with respect to their current plan? It is important to know what the client's objectives are rather than make assumptions. While the facts raise many issues, it is important to make sure the clients' needs and wishes are addressed – and that any

"hidden agenda" or issues involving family dynamics are disclosed or discovered.

4. Does Bill receive or qualify for provincial disability benefits? If so, the inheritance Bill receives from his parents may disentitle him to such benefits.
5. If Bill does qualify for provincial benefits, would his parents want to preserve the rights to such benefits even though preserving such right might restrict what Bill can inherit directly?
6. Are they interested in using a discretionary trust for Bill to provide for him but make it possible either to distribute unrestricted amounts to him (in which case he might lose benefits) or to restrict what he receives directly so that he continues to meet the means test for provincial benefits?
7. Is Toonie financially responsible? Do they have any concerns about Toonie receiving her inheritance directly, given the unstable nature of her relationships and the fact that she needs financial assistance from them? If so, it might be appropriate to suggest a trust to provide financial security for Toonie and her two children.
8. Are they interested in making any charitable gifts?
9. Is the cottage owned jointly with a right of survivorship? What are their intentions with respect to the cottage? Did Loonie contribute to the purchase price, or was it transferred to her by way of gift? If the cottage was transferred into joint names with Loonie without consideration and there is no documentation regarding their intentions, the cottage will be part of their estate. If this is not what they want, they need to document their intentions.
10. Are they aware that the insurance will form part of their estate if no beneficiary is designated? That could increase probate and executor

fees and delay the payment of proceeds as they will be tied up in the administration of the estate. It could also expose the insurance proceeds to their creditors on death.

11. What is the purpose of the joint insurance policy? Might it be used to fund a Henson Trust or other trust to preserve Bill's rights to benefits or provide him with some financial security? Is its purpose to fund any tax liability that will arise on the last-to-die of Penny and Nicholas?
12. What are the details of the insurance policies – type of insurance (term, whole life, universal life), premium costs, adjusted cost base, cash surrender value?
13. If there are probate fees in the province, are they interested in probate fee planning? They would qualify, for example, for alter ego or joint partner trusts. However, the value of the assets appropriate for such planning is probably too low. Nevertheless, some probate fee planning might be appropriate, such as joint investment accounts, and beneficiary designations for registered plans and insurance.
14. How do they want their children to benefit from their estates? Their existing Will provides for equal shares – is this still what they want? It is important to ask how parents see their children inheriting their wealth – each of their children are in quite different situations and asking this open-ended question ensures that the "equal" division is not just "rubber stamped" by the advisor.
15. Are they interested in creating testamentary trusts for their children to protect their inheritance from the claim of a spouse or common-law partner? Such trusts could protect an inheritance especially if the child would likely combine the inheritance with family assets or put it in joint names with the spouse thereby losing any protection for an inheritance under provincial law.

16. Are they interested in using testamentary family trusts for their children and their families to income split on a discretionary basis among other family members who are in the lower marginal tax brackets, such as their children or grandchildren or a low-income spouse of a child or grandchild?
17. What is the tax cost (ACB or adjusted cost base) of the home, cottage and other capital property?

Case Study 2: The Greenback's Estates

1. Dime can renounce as executor without court approval if he has not already started to act as executor. Once he acts as an executor under the Will, such as having assets transferred, he can only resign with court approval and will likely be required to pass accounts. For Loonie to act as administrator, Dime must formally renounce in writing and file the renunciation with the court, and Loonie must apply to the court to be appointed. Because she was not named in the Will as an executor or alternate, she may be required to post security adding to the costs of the estate. She will also be required to demonstrate to the court that she is an appropriate person to be appointed, and if others contest her application or file competing applications, the process could be costly, unpredictable, and time consuming. Since Loonie is concerned about the time required and the possible difficulties with the beneficiaries, she may want either to have a trust company act as agent for executor or have a trust company appointed either alone or along with her as co-executor. If she is co- executor or uses a trust company as agent for executor, she will not have to do all the administrative work. If she is co-executor, she will still be involved in all decisions, but the trust company can take on the burden of fielding demands from beneficiaries.

2. The RRSP will be received without any withholding tax in Loonie's hands. However, the $68,000 will be included in Penny's "terminal" year tax return. Loonie will not have any additional tax to pay as a result of being the beneficiary unless the estate does not pay the tax, in which case Canada Revenue Agency could require her to pay the tax.
3. Nicholas died first. His $35,000 registered plan will be paid to Penny's estate since she was the designated beneficiary and she was alive on his death. The full amount will be paid without any withholding tax as there is no withholding tax on funds paid from an RRSP when paid out as a result of the death of the annuitant. In the normal course, a rollover is possible if the funds are contributed to the plan of a surviving spouse. Further, if the spouse makes the contribution to his or her own plan, the personal representative must deduct the proceeds from the terminal return. (If the estate were the beneficiary this would have to be a joint election with the personal representative and the spouse.) However, since Penny died shortly after Nicholas, and did not contribute the plan proceeds to her own plan, no rollover took place, and even if Penny had contributed them to her plan, the proceeds would be taxed on her death in her final return. Nicholas' personal representative would have to decide in which final return the income from Nicholas' plan should be included to achieve the best tax result and make the election to deduct, or not, accordingly. Both of Penny's RRSPs will be paid to her estate since Nicholas, the named beneficiary, died first. These plans will be taxable in Penny's terminal return.

4. Assets subject to probate:

Asset	Penny (dies second)	Nicholas
Residence (survivorship)	$425,000	
Bank Accounts	$10,000	
Bank Account (survivorship)	$35,000	
Life Insurance (no beneficiary)	$125,000	$300,000
Life Insurance (no beneficiary)	$200,000	
Registered Plans	$230,000	
Registered Plans	$68,000	
Registered Plan from Nicholas	$35,000	
Investment Accounts	$640,000	$800,000
Cottage (in Ontario)		
TFSA	$11,500	$20,500
Total for Nicholas' Estate		$1,120,500
Net value of Nicholas Estate	$1,020,500	
Total for Penny's Estate	$2,800,000	

The value of assets subject to probate could have been reduced if there had been a named beneficiary for the insurance (e.g. the designation could have been in favour of each other). Since they are both 65 or older, they could have sheltered probate on the investment accounts and the home by using alter ego trusts, or joint partner trusts. If the cottage is still part of Penny's estate because the joint title was not a true gift to Loonie, then the value of the cottage would also be included in Penny's assets subject to probate. However, if it was intended that Loonie receive the cottage outright on the death of both her parents, then it is not part of either of their estate properties and is not subject to probate.

5. The value of Penny's estate before expenses from question 4 is $2,800,000 and expenses are $395,200. The distributable estate is the net amount, or $2,404,800. Estate expenses are calculated as follows:

Description	**Formula (where applicable)**	**Expense**
Probate fees	1% of $2,800,000	$28,000
Funeral expenses		$10,000
Real estate commission	5% of $425,000	$21,250
Executor's fees	5% of $2,800,000	$140,000
Accounting and legal		$11,950
Tax on gain on cottage	50% of (value less cost) x 50% inclusion rate for capital gains x 35% tax rate = ($92,500-$72,500) x 50% x 50%	$5,000
Tax on Penny's two registered plans	$298,000 x 50%	$149,000
Tax on capital gains	one half $120,000 x 50%	$30,000
Total Expenses		**$395,200**

Note that even though the cottage is not part of the estate, the one-half interest Penny held at death is taxable. The other portion of the gain should have been reported when Loonie was added as a joint owner.

6. Since there are three children who share the estate equally, each child will receive one third of $2,404,800 or $801,600.

7. If Loonie died before her parents, 100% of the cottage would be in Penny's estate since Penny would be the last to die of the three joint owners. The $68,000 RRSP would also be in Penny's estate. Thus, the value of assets to be distributed under Penny's Will would increase by $185,000 plus $68,000 or $253,000. The total value of the estate would be divided in three, one third to Bill, one third to Toonie. The remaining one third that would have been received by Loonie, had she survived her parents, would be divided equally among her three children.

8. The effect of a hotchpot clause for the cottage would reduce the amount of distribution to Loonie from the estate and increase each of her brother's and sister's share so that when the value of the cottage is included, each of the children receive an equal amount. The existence of such a clause in the Will might also be considered evidence that the value of the cottage was intended to pass to Loonie on her parents' death and that it should not be included in the value of Penny's estate.

9. Loonie should review her own estate plan to consider if any changes should be made in light of her separation. Depending on the province and the period of separation, any appointment as executor, gift in the Will and appointment as attorney to a spouse may be no longer valid (although the more likely scenario is that they are still valid, necessitating a change to her documents). She should also review all

beneficiary designations to ensure they are still appropriate. With respect to her inheritance, Loonie should get family law advice. In most provinces there is exclusion for property received by inheritance if it is kept separate from family property or can be traced to the inheritance. She should ensure that the funds from the inheritance are not mixed with other family assets so they do not lose their protection, although the fact that the separation occurred before the inheritance may exclude it from division in any event. Nevertheless, keeping it separate provides the maximum protection as there can be no argument in the future as to the source of the funds.

Case Study 3: Loonie and Jack: The Next Generation

1. The gain on the cottage is \$600,000 less \$160,000 or \$440,000 of capital gains. If she sells the cottage in 2020, the maximum years she may claim the principal residence exemption is for the number of years in the holding period for which no exemption has been claimed on any other residence. So, she may claim the exemptions for 2015 to 2020 or 6 years. She has held the cottage during 11 calendar years (2010 to 2020). The formula for the amount of exemption she could claim is the capital gain multiplied by a fraction whereby the numerator is the number of years claimed *plus one*, and the denominator is the number of years in the holding period. The exemptions would be as follows:

   $\frac{(6 + 1)}{11}$ X (\$600,000 - \$160,000) = 7/11 x \$440,000 = \$280,000

   So, the capital gain to be reported in the return is \$440,000 - \$280,000 or \$160,000. Of that 50% or \$80,000 is a taxable capital gain included in income.

2. First, Loonie should be realistic about her children's potential use of the cottage and their desire to maintain it. If she transfers it to a trust for their benefit now, she will not be able to reverse this later as the property will be owned by the trust for the benefit of her children. If she does transfer it, she should make sure there is an arrangement for the maintenance of the property and a lease or other agreement that Loonie and Jack can continue to use the property. She should consider discussing the future use of the cottage with her children. If she is not certain, she should wait. As can be seen from question 1 above, a sale of the cottage would result in a capital gain. A transfer to a trust would also be considered a sale at fair market value. If she is concerned about the taxes on death if the cottage is to be transferred then to the children, she could take out life insurance to fund the tax liability. In some situations where the children want the property, the children pay the premiums on the insurance.

3. Jack should make sure he provides for his illegitimate son in his Will. Failure to do so might give rise to a dependants' relief claim. He might consider an *inter vivos* trust for this child, but the attribution rules will apply on income (not capital gains) until the child turns 18. So, an *inter vivos* trust would probably not be advised, as Jack can continue the voluntary payments during his lifetime. He might also include a direction in his Power of Attorney for Property to make sure the voluntary payments are continued by his attorney if he becomes incapable.

4. Since Loonie and Jack want to preserve capital for their children in the event the surviving spouse remarries, it is best not to make the spouse the direct beneficiary. They could make the children the beneficiaries omitting the spouse altogether. However, this may expose the estate of the first to die to a claim for division of property

under family law, and/or a claim for dependants' relief. Also, they wish to provide for the surviving spouse while still protecting the children's interests. A spousal trust is one solution. It can be designed to achieve a rollover for income tax purposes if created in the Will, and during the lifetime of the surviving spouse all income is payable to the surviving spouse and no person other than the surviving spouse is entitled to capital. The children could be the beneficiaries on the death of the surviving spouse. There is no guarantee that the trust arrangement would protect the estate from a spousal claim, but as it would be more generous than disinheriting the spouse altogether, it would reduce the risk of a successful claim. Trusts for the children may be beneficial if additional family members are discretionary beneficiaries along with the child so the trust can be used to income sprinkle among family members in lower tax brackets. Note that they have kept their assets separate, which is consistent with funding a testamentary spousal trust on the first death, and a set of children's trusts on the second death. Trusts for children might also protect the children's inheritance from the claim by a child's spouse in the event of marriage breakdown or death. Another solution may be to simply give each other as much of their estate as the survivor will need to maintain their standard of living and buy insurance in order to create an estate of the desired amount for the children.

5. Toonie needs estate planning and family law advice. Depending on the province, she may not be entitled to inherit Bert's estate if he dies without a Will because they are a common-law couple and their relationship may not be recognized. Although in most provinces she would at least be entitled to make a claim for dependants' relief, this is not the case in every province. Toonie may have a claim for equitable relief against Bert and/or his estate in respect of her

contribution to the cottage property that is in Bert's name. While Bert and Toonie's children would inherit a share of Bert's estate on intestacy, Sam may not. We are not told whether Sam has been adopted by Bert or whether Bert treats Sam as his child. If adopted by Bert, Sam would inherit the same as the other two children. If Bert has raised or treated Sam as his own child, he may be considered as Bert's child for inheritance on intestacy, but this would depend on the facts and the details of provincial law. Inquiry should also be made as to whether Toonie and Bert have Powers of Attorney for Property and Personal Care. Toonie should also be concerned about Sam's welfare if she dies. Her only asset is the house and it will pass to Bert by right of survivorship. This would leave Sam with nothing, although a claim could be made for dependants' relief, depending upon their province of residence. Provincial law may provide that jointly held property is available to satisfy such a claim even if it passes to a third party.

Case Study 4: Big Banana

1. Based on the information given, the value of BB Holdco is $8,000,000 plus $1,500,000 for $9.5 million. At present the investments in the holdco, which are not used in the active business, exceed 10% of the value of the other assets in the group. Thus, the shares of BB Holdco are not qualifying shares of a small business corporation. The value of assets used in the active business carried on primarily in Canada must be 90% of the value of all assets at the time of the sale. (Note: there is a relieving provision in the case of death where a time period after death permits the estate to bring the corporation within the 90% test.) There is also a 24-month holding period required prior to the transaction that we are told is satisfied as the siblings have owned the shares for 10 years. During the 24-

month holding period a 50% test is also applicable that requires 50% of the value of the assets to be used in the active business throughout the period. Assuming this last test is satisfied, it may be possible for them to "purify" by extracting assets from BB Holdco tax-free into a separately held corporation. Alternatively, they could use the funds in the holdco to purchase business assets or pay salary or dividends to reduce the value of the non-business assets to 10% or less of the value of all assets.

2. Often the profits of an operating company will be pushed up to a holdco by way of a tax-free inter-corporate dividend to protect them from the creditors of the business.
3. Corporate-held insurance will be better than individually owned policies because the after- tax dollars used to fund the premiums will be cheaper from within a corporate vehicle. Funds paid to the individual shareholders to pay the premiums from the corporation will be taxed in the hands of the shareholder as a dividend, salary, or a bonus. As between BB Holdco and BB Ltd, it might be best to use Holdco to hold the insurance. In the event BB Ltd. is sold to an arm's length party in the future, the insurance policies cannot be extracted from the corporation without possible tax consequences.
4. The estate freeze:
   a. As mentioned in 1 above, the shares of BB Holdco will have to pass the 90% test and transactions will have to be completed to achieve this, either by way of a purification corporate reorganization or otherwise. It may be necessary to have the business value appraised to support the numbers used in applying the 90% and the 50% test. The value of the assets of the last 24 months will also have to be reviewed to ensure that the 50% test is satisfied.

b. A freeze could be completed either at the holdco or opco level. However, it might better facilitate future use of the capital gains exemption by the new common shareholders to do the freeze at the opco level and freeze BB Holdco's interest in BB Ltd., and issue new common shares of BB Ltd. This would also permit the siblings to benefit from the future growth of the portfolio in holdco, but not the value of the business carried on by BB Ltd. If the sibling shareholders can purify BB Holdco, they may want to crystallize their capital gains exemption as part of the freeze, and this would have to be done at the holdco level since only an individual may claim the capital gains exemption. In this case new common shares of BB Holdco could be issued, in which case the siblings would be giving up the future growth in value of both the business and the portfolio. Alternatively, there could be a crystallization by the siblings that is not a freeze, and the freeze could still take place at the BB Ltd. level.

c. The shares could be issued to a family trust, or directly to the children. In most cases parents want to continue to exercise a degree of control over the shares and defer the decision as to the actual succession of the business as among their children. Here we have three siblings. To permit each sibling to control the interest of his or her children separately, three separate discretionary family trusts might be created. The trusts could also permit income sprinkling among adult beneficiaries. It might also be possible to include each sibling as a discretionary beneficiary in the trust, if the trust is properly structured and funded. In addition to the children, the children's spouses and other issue could be discretionary beneficiaries.

If the children are adults, the shares could be issued directly to the children, assuming Edna and her sister and brother are comfortable with this. This would be something they should consider carefully both as between each of them and their children and as between themselves. A shareholders' agreement is always recommended in such a situation, particularly where there are partners in the business, and it is not owned by a single family member or a married couple. Each sibling should be protected from the other sibling and from their own children and their nieces and nephews.

Glossary

Abate: The reduction of gifts in a Will to satisfy debts and other expenses of the estate. The residue is exhausted first, then general gifts, then specific gifts other than real property, and last specific gifts of real property. Abatement has a similar meaning.

Adeem: A gift is said to adeem where the property gifted is no longer owned by the testator. For example, a gift of “my red Porsche” will adeem if the testator no longer owns a Porsche at the time of death. Ademption has a similar meaning.

Annual Gift Tax Exclusion Amount: The amount that can be gifted annually to any particular recipient, without attracting U.S. gift tax.

Cash Surrender Value (CSV): The amount, if any, available in cash upon surrender of a life insurance policy during lifetime of the insured, after all charges are incurred (i.e., some policies may impose surrender charges for early cancellation of a policy). Many policies, such as term insurance policies, do not have CSV.

Cash Value: This term is sometimes used interchangeably with CSV. However, it is also used to refer to the amount of the death benefit that exceeds the face amount; amounts attributable to dividends paid (and that during lifetime of the life insured are reflected in the CSV); or the value within the policy before surrender charges are applied.

Crystallization: A transaction whereby the capital gains exemption on qualifying property is realized for tax purposes only by incorporating the amount of the exemption into the cost base of the qualifying property. The owner of the property does not change, and generally proceeds are not received by the individual owner (although in limited circumstances non-share consideration may be received but the amount that can be received is restricted by the Income Tax Act). The purpose is to boost the tax cost of the property by the exemption in the event the property does not qualify for the exemption in the future.

Death Benefit: The amount payable from a life insurance policy to a named beneficiary as the result of the death of the life insured. For many permanent life insurance policies this includes the face amount and any additional amount attributable to the cash value of the policy.

Estate Freeze: A transaction whereby property of an individual is fixed in value but the value of the future growth is transferred on a tax-neutral basis to the persons who will inherit the property.

Executory Trust: A trust that is created outside the Will on the death of an individual. Such trusts are usually set up to be funded with life insurance proceeds on the death of the life insured.

Face Amount: The amount insured under a life insurance policy. It generally represents the amount of risk assumed by the life insurance company. It does not include other amounts such as policy dividends or cash value payable in excess of the face amount on the death of the life insured party. The face amount may also be referred to as the “sum insured.”

Guaranteed Cash Surrender Value: That portion of the cash surrender value of a life insurance contract that is guaranteed and is usually set out in the terms of the contract. The guaranteed cash surrender value does not include such variables as reinvested dividends. Only certain types of policies have guaranteed cash surrender values.

Hard Facts: Facts relating to a client’s personal and financial affairs that are objective and can be verified with documentation or third parties. A client’s date of birth or the value of the vacation property are hard facts.

Hotchpot: An adjustment clause, usually in a Will, that requires the inclusion of the value of other property from outside the estate to be added into the calculation for the purpose of determining the share of a particular beneficiary. For example, if the estate is worth $180,000 and is to be divided equally among three children, the share of each child would be $60,000. But suppose one child has already received insurance proceeds outside the estate of $30,000? A hotchpot clause in the Will requires the insurance to be brought into hotchpot in respect of that child's share and will result in that child receiving only $40,000 from the estate and the other children receiving $70,000 each. This has the effect of equalizing each child's benefit arising on death since each child will have received a total of $70,000, whether from inside or outside the estate passing under the Will.

In Kind: Refers to a transfer to satisfy a gift made by transferring property equal to the value of the required gift rather than in cash. For example, if the Will required a gift of $1,000 to a grandchild, and the Will permitted gifts to be satisfied in kind (sometimes referred to as "in specie") the executor could transfer a Canada Savings Bond bearing interest at current market rates with a face value of $1000 in lieu of making a cash gift. Similarly the residue of the estate could be distributed in kind from the assets of the estate without converting the property owned at death into cash.

Inter Vivos: During lifetime. Refers often to gifts made during lifetime or trusts created during lifetime as opposed to those on death.

Intestate: To die without a Will.

Issue: Lineal descendants related by blood or adoption – i.e., children, grandchildren, great-grandchildren. Step-children are not included unless legally adopted. Illegitimate children or other issue are included.

Life Insured: The person whose life is insured under the life insurance policy. There could be more than one life insured, such as with a joint last-to-die policy or multi-life policy.

Lifetime Gift and Estate Tax Exemption Amount: The value of an estate that will not be subject to U.S. estate tax. The exemption amount is the basis for calculating the unified credit. The unified estate tax credit, whether the full amount which is available to U.S. persons or the pro-rated amount which is available to non- resident aliens, will always offset all the U.S. estate tax on an estate with a worldwide value equal to or less than the Lifetime Gift and Estate Tax Exemption Amount in the year of death.

Marital Deduction: The deduction available under U.S. domestic law for the first to die of a married couple where both are U.S. citizens or other persons taxed as U.S. taxpayers, including U.S. citizens or U.S. Green Card holders. The deduction defers the U.S. estate tax on any amount left to the surviving spouse or certain spousal trusts, until the death of the surviving spouse. Married Canadians who are both non-resident aliens may only benefit from the marital deduction if the property is left for the benefit of the surviving spouse in a Q-DOT and no marital credit is claimed.

Net Cost of Pure Insurance (NCPI): This refers to the mortality cost as determined under the Income Tax Regulations. The NCPI is relevant for determining a policy's adjusted cost base, and for calculating the deductible amount of premiums where a policy is assigned as collateral for loans.

Non-Resident Alien: A person who is not a citizen of the U.S., or who is not otherwise a U.S. taxpayer. Under U.S. gift and estate tax law, residency is based on where an individual is "domiciled." The concept of "domicile" is different than residency for income tax purposes. A non-resident alien for gift and estate tax purposes is not a U.S. citizen, or a U.S. Green Card holder or foreign person who is "domiciled" in the U.S.

Per Capita: A distribution that is equal per person no matter what the relationship to the deceased.

Permanent Insurance: Insurance that continues for the life of the insured. Whole life and universal life are the two most common examples. These policies have a face amount and may also have an additional value that accumulates based on certain reserve calculations and investments of the premiums not required to fund the current cost of insuring the face amount. Over time the value of the CSV or cash value on death can exceed the face amount, although this is not typical.

Policy Owner: The person who has legal ownership of the policy and who has the right to designate a beneficiary. Change of ownership is a disposition for tax purposes and any gain or loss is not a capital gain or loss, but an income account.

Proponent: The person who is supporting the validity of a position or document. In reference to a Will, it refers to the party seeking to have a Will probated, and who is asking the court to formally approve of the Will.

Purification: A transaction whereby the assets in a corporation are altered so that 90% of the value of the assets in the corporation (or in the corporate group where there is more than one corporation) is used in an active business carried on primarily in Canada. Usually this is accomplished by a corporate reorganization whereby non-qualifying assets are stripped out on a tax-deferred basis to a corporation held separately by the individual shareholders.

Qualifying Spouse Trust: A trust settled for the benefit of the settlor's spouse whereby during lifetime of the spouse all the income (but not necessarily capital gains) is payable to the spouse and no person other than the spouse may have any right to the capital of the trust. There is a rollover available for capital property transferred to a qualifying spouse trust either during lifetime of the settlor, or to a qualifying spouse trust established under the terms of the Will.

Quantum Meruit: An equitable remedy that awards compensation for the value of services provided gratuitously.

Resident Alien: For U.S. income tax purposes, this includes a U.S. Green Card holder or a foreign person who meets the substantial presence test but who has not claimed a closer connection exception (not available for U.S. Green Card holders) or a treaty exemption. For gift and estate tax purposes, this includes U.S. Green Card holders and foreign persons who are “domiciled” in the U.S.

Soft Facts: Information relating to a client’s views, judgments, wants, and philosophy that are subjective to the client. The fact that a client is concerned about the potential claim of a difficult son-in-law, for example, is a “soft fact.” Soft facts often influence a client’s objectives.

Term Insurance: A life insurance policy that covers a specific period, such as one or more years, after which the insurance expires. It pays a death benefit equal to the face amount if the life insured dies during the term, although there may be additional benefits or riders, such as conversion rights, and options for additional terms. It has no CSV and is the cheapest form of life insurance over the short term. Over the longer term, however, term insurance can become extremely expensive. For this reason it is recommended for short-term insurance needs, but not for the permanent needs that frequently arise in an estate planning context.

Testamentary Trust: A trust created as a result of the death of an individual, usually in a Will. Executory trusts are also considered testamentary trusts.

Unified Estate Tax Credit: The amount of the U.S. estate tax that can be sheltered by the Lifetime Gift and Estate Tax Exemption Amount. A U.S. citizen or resident alien will be able to claim the full amount, but a non-resident alien is entitled to a pro-rated amount based on the proportion of the value of the deceased's estate, which represents U.S.-situs property.

U.S. Citizen: An individual who has U.S. citizenship. A person born in the U.S. or a person who is born to a U.S. parent in a foreign country may have U.S. citizenship.

U.S.-Situs Property: For the purposes of the U.S. rules this is property that is subject to U.S. estate tax and U.S. gift tax for persons who are non-resident aliens of the U.S. Certain intangible U.S. property is U.S. property for the purposes of U.S. estate tax, but not for the purposes of U.S. gift tax.

U.S. Taxpayer: An individual who is a U.S. citizen or U.S. resident alien for U.S. income tax purposes.

Universal Life Insurance Policy: A life insurance policy in which premiums (less expense charges) are credited to a policy account from which periodic charges for life insurance coverage are deducted and to which interest or investment earnings are credited. Policy owners are able to choose from a variety of investment accounts. Usually the policy owner can vary the amount and timing of premium payments and change the amount of insurance (subject to underwriting).

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