

TAX-EFFICIENT TRANSITIONS

GUIDE TO PASSING ON WEALTH

Planning for death is difficult, because it's an emotional topic. However, to preserve wealth, it's important to employ a checklist to enable a thorough discussion and encourage trigger questions.

Check off items you would like to discuss:

- Reducing annual income taxes payable by your spouse, children or other beneficiaries on inherited funds
- Making special arrangements for infants, disabled children or any other disabled beneficiaries
- Setting up special trusts for the education of your grandchildren
- Making arrangements to protect your beneficiary's inheritance if their marriage breaks down
- Protecting adult children with poor financial judgement or money management skills
- Supporting your current spouse while ensuring that capital passes to children from a previous marriage
- Holding portions of inheritance until your children attain responsible ages
- Keeping your children in the family home, or ensuring suitable accommodations
- Providing financial support with testamentary guardians for special needs while growing up
- Protecting your children against undesirable custody or guardianship applications by non-custodial parents
- Options available for cottage or summer home succession planning
- Charitable donations, charitable remainder trusts, charitable gifts of securities
- Gifts of specific items (like jewellery and artwork) to friends or family
- Special directions to secure financial or other advice from specific advisors whom you would like to recommend for the benefit of beneficiaries
- Arrangements for cremation, burial or a wake

Responsible planning can make an important difference when a person passes away. As wealth passes to the next generation it is an opportunity to pursue the best possible results.

Some government taxes can be minimized, and good planning can help avoid family disputes. These can be significant wealth eroders. Careful and responsible planning can reduce taxes and make disputes less likely.

This guide deals with the strategies designed to achieve better results when you pass away, and measures to avoid the taxes and other influences that erode wealth or would otherwise reduce your ability to make a positive difference in the world you leave behind.



NEUTRALIZING FAMILY CONFLICT

There are three categories of tools that can be used to preserve wealth for blended families.

1. Immediate distributions – Some or all of the wealth can be distributed at the first death and given immediately to the deceased's children. This assures the children that they will inherit. The surviving spouse, however, has legal claims that might be brought to demand more, and those claims must be controlled.

- Limiting community property claims – Each of the spouses can sign a release or agreement promising not to attack the estate and demand anything more than their pre-agreed due under the will.
- Limiting claims as a 'dependant' – There are other claims that can be brought against the estate as a 'dependant.' Those claims cannot be signed away in a release or agreement, but can often be avoided. This is generally done by passing wealth outside of the estate, through beneficiary designations, joint ownership, and inter vivos trusts. In most provinces, the dependant's attack is limited to estate assets and an empty estate thwarts their claim.
- Insurance – One of the simplest ways to achieve an immediate distribution is to have a significant life insurance policy, sending the proceeds at death directly to the children, and leaving the whole of the remaining estate to the surviving spouse.

2. Promises – The next tool is a promise between the spouses. The spouse who passes away first passes some or all of the wealth to the other, but the survivor promises that they will leave some or all of it, in turn, to the children. The promises are mutual, and are generally set out in a written agreement, sometimes referred to as a 'distribution agreement' or 'estate plan agreement.' Asking the spouse to sign a release promising not to dispute the estate plan is good planning.

When the survivor passes away, the stepchildren can enforce the promise against the estate if the survivor signed a later will breaching the agreement and attempting to redirect the wealth to a different destination.

3. Trusts – A trust is the third type of tool used in estate planning. Trusts tie up assets outside of the direct ownership of the spouses and introduce a measure of outside oversight. They allow a surviving spouse access to income, and access to capital where it is required for legitimate purposes, but do not allow for the wealth to be gifted away or made joint with some other new heir. As such, they offer strong protection for the children but discomfort for the step-parents.

- Spousal testamentary trusts – The most common type of trust in this setting is a spousal testamentary trust. It is set up in the wills. When the first spouse dies, some or all of their wealth passes through the estate and into a spousal trust. The income on the assets in the trust is given to the spouse. The capital is preserved, and not released to the spouse. An emergency capital clause can be built into the will. When the surviving spouse dies, the remaining capital goes to the children. The surviving spouse does not own the assets in the trust, so his or her will is irrelevant to them. The trustees own the assets.

How is the trust taxed? Assets can pass from the deceased spouse into the testamentary spousal trust without triggering capital gains. The capital gains are deferred until the demise of the spouse beneficiary and are then taxed on the trust's tax return. The trust is a separate taxpayer, files its own tax return, and gains access to a separate set of graduated rates.

Only a portion of the wealth is protected in a testamentary spouse trust – the wealth in the name of the first spouse at the time he or she passes away. The surviving spouse often has significant assets of their own. Those are not in the trust and as a result are not protected.

- Joint partner trusts – Some couples will put assets into trusts while both are still alive. Each signs a separate joint partner trust and passes all of their investment and other property into the trusts, including cottages and houses. Registered investments are left outside of the trusts, as inclusion would trigger immediate income tax. The family wealth builds inside the trusts. The trusts are structured so that the capital, at the second death, goes to the children.

While the spouses are alive, they have the income from the assets. Capital can be deployed for their continued support and benefit as well. When one dies, or becomes incapacitated, the children or a trust company steps in to serve alongside the spouse who remains capable.

This kind of plan is strong protection for the children but it is rife with disadvantages for the parents. Assets can be rolled in without triggering capital gains but only if the parents are age 65 or older at the time. The trusts are called 'inter vivos' trusts, not testamentary trusts. No tax savings are available to offset trustee fees. As soon as the trusts come into existence, a tax return has to be filed each year for each trust. This kind of planning does avoid probate fees or taxes in jurisdictions where they are an issue.

Visit with your advisory team soon to implement the best solutions for your family.

Which strategy is right?

Having reviewed immediate distributions, estate distribution agreements, and trusts, which solution is right? Every blended family is different. Fortunately, the tools can be used in combination.

Consider an individual with some wealth who has remarried a person with less wealth. The individual might divide their wealth into three equal parts under their will. The first part would be given directly to their children. The second part might be placed in a spousal trust for the support of the new partner but directed under the terms of the will to the children when the new partner later passes away. The third part could be given directly to the new partner under the terms of the will, but subject to an estate plan agreement between the individual and the new partner. The terms of that agreement would oblige the new partner to maintain a will in favour of the children left behind by the deceased spouse.



What are you doing after work?®

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