

- Client Information Summary -

The Principles of Estate Planning

The estate of an individual can be described as the collective assets owned by that individual and, if any, the related liabilities. Accordingly, anyone with assets needs an Estate Plan.

Estate Planning is the art of designing a plan for the effective enjoyment, ownership, management, control and subsequent disposition of assets (during life, upon death, and after death), at the minimum tax cost.

The Estate Planning process requires technically competent advisors who possess considerable skill and knowledge. The advisors must be aware of the personality of the individuals, their goals and objectives, their priorities and preferences, and their personal relationships. Since decisions affecting Estate Planning are very personal, sensitivity is critical in supplying advice or applying technical knowledge. Without sensitivity, it would be impossible to create an Estate Plan that will recognize the goals and concerns of all parties involved.

Regardless of age, the Estate Planning process cannot be ignored. It is an essential and important part of personal financial management. Many believe that Estate Planning is only for those who are of advanced age or who are approaching death. This is a misconception. The waste of a single asset to taxes could hinder the accomplishment of the desired objectives and bring hardship to the family unit or business. For this reason, Estate Planning may be even more important to the owner of a small or medium-sized estate than to the owner of a large estate.

The fundamental objective of Estate Planning is to nurture wealth building in one's own estate while minimizing the overall tax burden for all beneficiaries. Thus, Estate Planning is **all** of the following: the creation of wealth, the preservation of wealth and the conservation of the estate at death, or even beyond death.

The goals of Estate Planning are many, and varied, however they are all encompassed by the following four principles:

- 1) Meet your own needs first.
- 2) Protect your estate from erosion caused by taxes and other expenses.
- 3) Judgment proof your estate to the maximum extent possible.
- 4) Distribute your estate in an orderly fashion.

Let's take a closer look at each of these principles:

Principle #1—Meet Your Own Needs First

A sound estate plan is the final component of a well-constructed overall plan to achieve your life goals.

While it's admirable to want to maximize your estate for your beneficiaries, care must be taken so you don't sacrifice your personal lifestyle and dignity to accomplish this objective. In fact, there are many ways to maximize the estate without materially impacting your personal lifestyle.

Accomplishing both objectives is the best goal to have so that you can both enjoy your life and know you have done all that you can to provide for your beneficiaries.

Principle #2—Safeguard Your Estate To The Maximum Extent Possible

Creditor Protection and Judgment Proofing—While this isn't a concern for everyone, it certainly is for individuals who are professional practitioners or business owners. It's important to judgment-proof and creditor-proof assets in the estate in order to protect them against malpractice lawsuits, litigation and creditors. Otherwise assets can be attacked and decimated through court awarded judgments.

Domestic Contracts – The Family Law Act (and other similar pieces of provincial legislation) has provisions that ensure that your spouse receives a portion of your estate. In cases where the rules of the FLA do not fit your situation, domestic contracts can help.

Domestic contracts allow for the FLA rules to be set aside. This can be very important in cases of a second or subsequent marriage where there are children from a previous marriage and when there are concerns about the children receiving the appropriate inheritance.

Enduring Power of Attorney for Property – This important document can be very important should you become incapacitated. To be valid under these circumstances the document must have an "enduring" clause so that it will be valid while you are incapacitated. Having this document in place ensures that your property is managed on your behalf when you are unable to do so.

Principle #3—Protect Your Estate From Erosion Caused By Taxes And Other Expenses

Maximizing your estate through expense reduction strategies is a sound objective no matter how big or small your estate is. This can be accomplished in several areas:

Minimize Taxes – Everyone would like to pay less tax. When doing estate planning some unique opportunities exist to accomplish this objective. Some of the techniques include:

- § Use rollover provisions to preserve your estate at time of death. For example RRSPs and assets with un-crystallized capital gains can roll to a surviving spouse, without triggering a disposition or taxation.
- § Income splitting between spouses, children or members of the extended family (grandchildren, nieces, nephews, etc.) can save thousands of dollars in taxes.
- § Tax sheltering of investment income on assets to be passed on to the next generation can significantly reduce overall taxation on the estate. In fact, it is possible to eliminate taxation on all growth within the tax-sheltered environment.
- § An Estate freeze can help transfer future growth in certain assets (typically businesses and farms) to the heirs. This is done in order to maximize estate values by deferring taxes or utilizing the available capital gains exemptions of other family members.

Minimize Probate Fees – Probate fees are levied against estates based on the **gross** value of the assets, not the net value. These fees can be reduced using several techniques:

- § One of the more popular methods is through the use of joint ownership for certain assets. With joint ownership, the asset does not form part of the testamentary estate since the ownership passes to the surviving joint owner automatically at the moment of death.
- § Use of joint ownership with right of survivorship must be used with care for several reasons. First of all, if you are joint owner with your spouse, you must take care to track the original source of funds so you don't lose track of to whom the taxable income belongs. Secondly, if you are a joint owner with your children, this could cause problems if you are trying to equitably distribute your estate. You might unintentionally cause unplanned inequities in your total estate distribution.

- § Another simple and easy to implement method is to use named beneficiaries for certain assets, such as life insurance proceeds, pension plans, RRSP etc. This avoids probate since the proceeds pass directly to the beneficiary.
- § Assets subject to transfer at death pursuant to a legal agreement, such as a domestic (marriage or cohabitation) agreement, may also avoid probate.
- § Gifting of assets or transfers to trusts prior to death will avoid probate, but care must be taken to track and report taxable income under the attribution rules relative to gifted or transferred assets.

While reducing probate fees is a very valid objective, no action should be taken that could jeopardize your overall estate planning objectives. This is because probate fees, relatively speaking are fairly modest in the overall scheme of things.

U.S. Estate Tax – Under U.S. tax legislation, Canadians, who are non-resident in the U.S. but have assets situated in the United States, are liable for estate taxes in the event of a death when certain thresholds are exceeded.

Assets include real property, unincorporated business interests, shares of U.S. corporations, mutual funds based in and operated from, the United States, debt obligations of U.S. corporations, included as debt obligations are pension obligations of U.S. corporations (but not those of Canadian subsidiaries). Assets also include partnerships or trusts and tangible personal properties located in the United States (clothing, jewelry, automobiles, boats, furniture, works of art, currency and club memberships).

These properties may also face Canadian capital gains tax as well, without receiving any credit for the U.S. estate tax paid, resulting in very onerous tax liabilities for the U.S. portion of a large estate. Excluded are life insurance proceeds and most bank deposits (if not connected with a U.S. trade or business).

Should you hold any U.S. property as described above, a thorough review of your situation should be done to assist you in minimizing the estate tax liability.

Avert "Estate Sales" Caused by a Liquidity Crisis – Taxes triggered by the deemed disposition of certain assets upon death can create a liquidity crisis. This can result in assets having to be sold at an inopportune time or at depressed values to create needed cash.

Ensuring that there is adequate liquidity (such as the use of life insurance) in the estate to cover unavoidable expenses can mean the difference between having an orderly and well-executed disposition versus one where chaos reigns.

Reduce Legal and Accounting Fees – Probably the most common cause of unnecessarily high legal and accounting fees is where the affairs of the testator are poorly planned and disorganized. In such cases the legal and accounting professionals have to spend much more time filtering out the issues and thus their billings are higher than would otherwise be necessary.

The obvious answer to this problem is to ensure that you plan your affairs wisely and organize your situation so as to incur a reasonable level of professional fees.

Principle #4—Distribute Your Estate In An Orderly Fashion

Maintain Family Harmony – Nearly everyone knows of a case of disruptive family relations precipitated by the death of a family member. Such circumstances are typically due to the lack of a formal Estate Plan.

Similar conflicts may also occur while you are alive when certain assets are gifted or sold to family members to the exclusion of others, based on needs or ability (e.g. assistance on down payment for first house, involvement in family business).

In order not to cause conflict among family members, compassion should be exercised in a discreet manner. A well-intentioned but poorly drafted and executed plan can create emotional scars. A classic example is the bequest of the family cottage to the child who will enjoy that lifestyle the most, while leaving a second child the investment portfolio of similar

value at time of drafting one's Will, only to have very disparate values later at time of death. Good planning does not leave intentions and fairness to chance.

Retain Key Assets within the Family – In many families there are *key* assets that hold some special significance. It might be a cottage that has been in the family for many years. Or it might be a business that has been built from scratch that is very important to the family. However poor planning can result in these *key* assets having to be sold in order to provide the needed cash to pay taxes (capital gains), cover final expenses, or other bequests leaving the true intentions and wishes unfulfilled.

Trusts and Gifts to Provide Capital Needs of Family Members – You can provide for the needs of family members through the use of lump sum gifts while you are still alive (inter-vivos gifts). Because there is currently no gift tax in most jurisdictions in Canada, this can be an effective way to transfer wealth to your beneficiaries. Such gifts may also be conclusive and potentially beyond any future challenge as to the intentions of the testator's Will.

A similar result can be obtained through the use of an inter-vivos trust. Assets can be placed in a trust that has specific terms as to payments and disbursement of the funds. In this way the trustee of the trust can retain more control over those assets. Alter ego or joint partner trusts for those over age 65 also provide unique planning opportunities.

Testamentary trusts are set up as a result of instructions in a Will. These trusts may be appropriate for larger estates where the assets are likely not needed by the beneficiaries for their lifestyle. The terms of the trust can specify beneficiaries for both income distributions and capital. While the beneficiary can be the same for both income and capital, it can also be different, thus allowing a portion of a large estate to by-pass certain beneficiaries with a "generation-skipping" trust.

Provide for the Financial Security of Survivors and Loved Ones – This could include:

- § Use of life insurance to create immediate capital at death and to offset the lost income of the deceased.
- § Use of various trusts to conserve existing capital until designated disposition dates.
- § Use of various trusts or life interests to provide continuing funds for certain beneficiaries while alive, with the assets remaining to pass to another beneficiary.

Business Owners – Ensuring business continuity is often one of the most important objectives of a business owner who has worked hard for many years to build a business. There are many issues facing the business owner where they must make prudent decisions, which will impact on the surviving owners, their family, their successors and managers.

With most successful business owners, the business represents a significant asset in the estate; therefore, the orderly succession is critical to developing an effective Estate Plan.

These issues include the question of control, estate freeze, liquidity, providing for the survivors, retirement, and permitting family and/or outsiders to participate in the business. The existence of a business adds to the complexity of the estate. Therefore planning should not be restricted to family members but include financial, legal and accounting advisors, as well as managers, executors and trustees.

Without an Estate Plan, the surviving family members of the business owner may be faced with a financial crisis in the event of the disability or death of the business owner due to their lack of knowledge of the affairs of the business.

For a business with multiple owners, an Estate Plan must include well-drafted shareholders' agreements with specific buy-sell provisions.

Multiple Wills and Estate Plans for a Multi-Jurisdictional Estate – A large estate with sizeable assets in several jurisdictions may be better administered via an inter-vivos trust or at death, with separate Estate Plans and separate Wills stipulating the disposition of the local assets situated in each of the countries.

Multiple Wills can be probated without holdups in each of the multiple jurisdictions.

In Conclusion

Awareness of Estate Planning creates the impetus to pull together all components in the financial and personal affairs of the individual and their heirs into a viable and workable plan, with help from competent advisors.

Estate Plans range from a simple Will and purchase of life insurance to a complex set of trusts and holding companies. Other progressive planning strategies involve crystallization of capital gains, estate freezes, transfers or gifts of properties, use of direct beneficiaries outside of the testamentary estate, joint title or life interest in properties, offshore trusts, joint, alter ego and spousal trusts, just to name a few.

Effective Estate Planning requires the advice of specialists from all fields (taxation, estate law, family law, and insurance). Since each case is different, a complete understanding of the relevant facts as well as the needs and intentions of the individual and the heirs are essential as preliminary steps in developing an Estate Plan. None of these factors can be dealt with in isolation.

This task is less onerous when completed under the auspices of a strategic advisor to effectively co-ordinate the development and implementation of a framework for decision-making and subsequent action. Without this framework, along with ongoing evaluation, an individual may end up receiving what appears to be conflicting recommendations from various advisors.

Once an Estate Plan is completed, it should be reviewed periodically to ensure that changing circumstances, such as divorce, death, disability or re-marriage, do not result in unintended beneficiaries. A review is also recommended after any tax law changes.

This information summary is intended only to increase the awareness of Estate Planning for the reader. You should consult your personal advisor for individual recommendations and other Estate Planning issues not covered in this summary.