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Death & Taxes

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JANUARY 28, 2010
VICTORIA, BC



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DEATH & TAXES

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AGENDA


- Things to consider before death
- Tax planning and other matters after death
- Tips & Traps


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"The art of taxation consists of plucking the goose so as to obtain the most feathers with the least amount of hissing."

(Jean-Baptiste Colbert (1619-1683))




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THINGS TO CONSIDER

BEFORE DEATH

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Starting point

- You die tomorrow - what happens?
- For Spouses - Key is the second passing
- What do you own (joint tenancy)
- Insurance
- Beneficiaries named?
- Are there companies?
- The wills
- Difficult to gather the info?
- Accountant often has some key (but not all) info

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Joint tenancy often bad

- Why do people think it's smart
 - lower probate or legal fees
 - keeps things simpler
 - Avoids income taxes
- OK with spouse only
- Problems
 - Likely results in immediate tax
 - Inflexible, difficult to reverse
 - Values fluctuate or disappear
 - Tax paid by residual beneficiary

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Naming a Beneficiary

- Examples are RRSP's and Life insurance
- Same motivations and problems as with Joint tenancy
- Is often done without adequate consideration to future estate and tax consequences

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KISS principle

- Keep it simple - unneeded creativity can cause big problems
- E.g. - instead of leaving all assets to spouse, assets that trigger tax are left to a child
- E.g. - making a charity a residual beneficiary – results in circular tax calculation, uncertain donation receipt amount

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Family Meetings

- Families can be destroyed over trying to whip fairness on the kids that they don't want or need
- Say one kid got more help - are you sure your kids want this inequity corrected?
- E.g. - can maintain proper legal records of loan balances with kids
- Not easy but better than changing your will
- May need expert help

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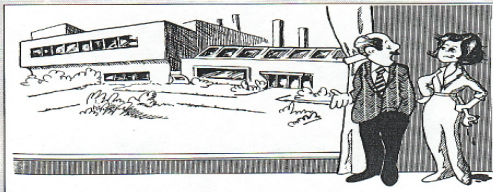
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Someday, Honey, this will all be your brother's.

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Estate matters

- Few estates are simple. Even small estates can become complicated:
 - Can be affected by RRSP, real estate, missing documents, etc.
 - Poorly-worded Will can have income tax effect
 - Executor's residency affects taxes, residency of Estate
 - Beneficiary's residency can affect distributions
 - GST/PST often forgotten, should not be ignored

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Estate matters

- DRAFTING OF WILLS & INCOME TAX
 - A properly-drafted Will is critical
 - Review and update your Will regularly
 - Proper tax planning saves taxes in the long run
 - Equal vs. equitable
 - Powers of Attorney could cause corp. association
- Keep status of beneficiaries in mind (spouse, minor children)
 - Is a trust appropriate (spousal, minor children)?
 - Who will be the Trustees?
 - Legal guardian of minor children?
- Funding of income tax cost?
- Affairs in order, to minimize taxes?

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Tax matters

- TAX IMPLICATIONS ON DEATH:
 - Deemed disposal at FMV
 - Income accrual to date of death
 - Can file separate returns:
 - Regular return
 - Rights & Things
 - Business income from partnership/proprietorship
 - Beneficiary of Testamentary Trust
 - Can claim personal exemptions on returns
- Returns due later of 6 months after death or normal deadline
 - Donations (through Will, one-year carry-back)
 - Medical expenses (24 months)
 - Capital losses (against other income, one-year carry-back, reduced if previously used CGE)

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Tax matters

CERTAIN ASSETS CAN GENERALLY TRANSFER TAX-FREE:

- Insurance
- Principal residence
- Joint bank accounts
- Joint G.I.C., term certificates
- Shareholder loans
- TFSA

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Tax matters

CERTAIN ASSETS GENERALLY HAVE TAX IMPLICATIONS:

- RRSP
- Company pension
- Stocks & bonds
- Shares of privately-owned company
- Real estate (except principal residence)

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Tax matters


• ASSETS WITH TAX IMPLICATIONS:

- Assets to spouse can go tax-free
- Certain Farm/Fishing assets can go to children tax-free
- Some RRSP can go to dependent children (tax deferral only)
- Other factors can affect income tax - e.g. Shareholders' agreements, cash requirements for family, taxes
- Shares of private business corporations, certain farm/fishing property and the capital gains exemption

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Filings – what & when


- Consider waiting till the slips are out
- Can often get clearance even though returns are not filed
- Extra returns can be done but consider the benefit, cost and delay
- Talk to the Tax Dept
 - Generally they are very helpful
 - Little reason for the advisors not to talk to them


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Tax Clearances

- Protection for the executor
- Do they need it?
- Does cause extra cost and delay
- Often a clearance to date of death is all you need


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Some tax plans

SITUATION # 1

- Investor with stock/bond portfolio
- Has invested for a number of years
- Significant accrued gains on the portfolio
- Wants to provide continuing income, and reduce taxes on death
- Has adult children

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Some tax plans

SITUATION # 1

Possible Plan of Action

- Incorporate holding company
- Transfer portfolio on tax-deferred basis, for note/preferred shares
- Common shares held by adult children
- Pay dividends on/redeem preferred shares over time

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Some tax plans

SITUATION # 1

Issues

- Control?
- Income?
- Give up right to asset, allocation determination?
- Family Trust?
- What happens on death?

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Some tax plans

SITUATION # 2

- Shareholder of family-owned investment company
- Had completed an estate freeze several years ago
- Common shares owned by children, preferred shares by parents
- Parents are close to redeeming their remaining preferred shares, want continuing income stream

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Some tax plans

SITUATION # 2

Possible Plan of Action

- Re-freeze?
- After re-freeze, shares to parents or to family trust?
- Employ parents in the company?
- Children provide for parents?

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Some tax plans

SITUATION # 3

- Shareholder of family-owned operating company
- Wants to retire, pass business on to children
- Wants to protect their value in company
- Wants to retain control, but pass growth to children
- Wants to ensure retirement is looked after, and taxes minimized

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Some tax plans

SITUATION # 3


Possible Plan of Action

- Complete estate freeze of company
- Exchange current common shares for preferred shares
- New common shares issued to children
- Pay dividends on/redeem preferred shares over time

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Some tax plans
SITUATION # 3

Issues


- Holding company?
- Trust(s)?
- Control?
- Retirement income stream?
- What happens on death?


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TAX PLANNING


AFTER DEATH

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Terminal return (T1)

- Deadline is later of 6 months after death or April 30 of following year
- Example, death on November 26, 2009:
 - 2009 return due on May 26, 2010
- Example, death on March 1, 2010:
 - 2009 return due on September 1, 2010
 - 2010 return due on April 30, 2011

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“Rights and things” return

- Optional return
- “Double up” on most personal tax credits (exceptions include transfer of unused credits from spouse, transfer of tuition credit)
- Income that can be reported on this return
 - Dividend declared at death, but not paid
 - Unused vacation leave
 - Inventory of farmer who reports on cash basis
 - Interest accrued at death, but not paid (e.g. bonds)
 - CPP/OAS/pension where entitlement vests before death (usually 1st of month) and paid after death (usually end of month)

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Other optional returns

- Business income from partnership or proprietorship (where non-calendar fiscal year, and 2 fiscal years end in same year because of death) – now rare, as most are calendar year-ends
- Income from testamentary trust, where deceased is a beneficiary of testamentary trust

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Trust return (T3)

Testamentary trust created by will on death

- Province of residence same as executor
- Deadline is 90 days (not 3 months) after year-end
- Year-end can be chosen, usually 1 year after death.
- If substantial portfolio investments, consider year-end of December 31 or January 1 – easier to reconcile investment income to statements and T-slips.
- Graduated personal tax rates apply
- No personal tax credits

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Trust return (T3) - continued

- AMT applies
- \$40,000 AMT exemption shared between multiple trusts created by deceased
- If income is payable to beneficiary
 - Beneficiary pays tax
 - Deductible to trust
- Income to beneficiary generally in same form as earned by trust (e.g. capital gains, dividends)
- If trust pays tax, distributions are capital distributions to beneficiaries – generally tax-free
- If will requires income to be paid to beneficiary, can elect for trust to pay the tax.
- ACB of property = FMV at death, unless rolled over
- Capital losses realized in first fiscal year of trust can be carried back to terminal return

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SOME TIPS

- spousal RRSP contribution, to 60 days after y/e
- pre-planning for death - multiple trusts?
- shareholder agreements could allow for 2 CGE
- Possible election to keep income in testamentary trust, use graduated tax rates
- deduction of capital losses in year of death & prior year (watch CGE used)
- use of donations in year of death & prior year
- medical expenses for 24 months
- Capital distributions from Estate to resident beneficiaries generally tax-free
- \$10,000 tax-free death benefit from employer or personal corporation

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SOME TRAPS

- watch GST implications on and after death (e.g., business assets, commercial property, raw land)
- shareholder agreements may preclude spousal rollover
- non-resident executors may create non-resident trust for tax purposes
- 21-year deemed disposition in trust
- Distributions from Estate to non-resident beneficiaries are a taxable distribution, require clearance or withholding taxes
- Real estate, shares of private corporations, or other investments will require special planning – **important that you get professional advice before any action taken!**
- Ensure you track cost of investments, other tax information

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PLANNING


- **DON'T DIE**
- **SPEND IT ALL BEFORE YOU DIE (YOUR LAST CHEQUE BOUNCES?)**


OR

- **REGULARLY REVIEW/UPDATE YOUR WILL**
- **PROPER AND REGULAR TAX PLANNING**
- **PROPER RECORD KEEPING**


EACH ESTATE HAS OWN UNIQUE ISSUES


THERE IS NO "ONE SIZE FITS ALL" ANSWER

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QUESTIONS?

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THANKS FOR LISTENING!

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