Reprinted From:

FRPO'S FAIR EXCHANGE OF RENTAL INDUSTRY NEWS

the voice of the Federation of Rental-housing Providers of Ontario

Are You Properly Prepared?

The Importance of a Well Structured Will

By Ralph Rabinowicz, Armando Iannuzzi and Jason Simon

The Canadian income tax system is structured in such a way that taxpayers and their estates are often liable to pay significant taxes upon their death.

These taxes can represent a large proportion of the value of the deceased's estate and can significantly reduce the amount of residual assets available for distribution to the estate's beneficiaries.

Fortunately, the tax that an estate will be subject to is not set in stone and by a properly structured will, a taxpayer can significantly reduce the taxes payable on their final income tax return as well as the taxes that will be payable by their estate subsequent to their death.

A strategy that can be used to reduce a taxpayer's liability on a final tax return involves the drafting of a will that leaves assets to their spouse rather than other beneficiaries.

Upon the death of any Canadian taxpayer, he or she is deemed to have disposed of all capital property they owned prior to death at an amount equal to the fair value of the property at that time. If the fair value of the property at death exceeds the cost that the taxpayer originally paid to acquire the property, the taxpayer will be subject to tax on the excess.

The Canadian Income Tax Act allows a taxpayer to avoid this deemed disposition on any assets left to their surviving spouse either directly or through a properly structured spousal trust.

If a taxpayer dies intestate (i.e. without a will), the courts of the taxpayer's province will determine the distribution of their assets often resulting in the distribution of assets to beneficiaries other than the surviving spouse. The existence of a will that clearly indicates a taxpayer's wishes to leave their assets to a surviving spouse can therefore significantly reduce the taxes payable on their final tax return as this ensures that the tax free spousal rollover occurs.

Although a spousal rollover can reduce taxes payable on a final tax return, it may not be consistent with a taxpayer's wishes to leave all their assets to their spouse.

If a taxpayer wishes to leave assets to beneficiaries other than their spouse, the use of multiple testamentary trusts can be an effective strategy. A testamentary trust allows a taxpayer to leave the beneficial interest in their assets to specified beneficiaries but appoints a trustee to manage and control those assets. Any income earned by the assets held in a testamentary trust will be taxed at marginal tax rates equal to the marginal tax rates available to an individual.

A taxpayer can achieve significant tax savings on the income earned on their assets subsequent to their death by wording their will in such a way that creates separate testa- mentary trusts for each of the estate beneficiaries. This allows each trust to have access to its own marginal tax rates thus reducing the tax payable on the income earned on the taxpayer's assets.

In addition to income tax, the assets of a taxpayer's estate may also be subject to an estate administration tax, (also referred to as "probate fees") in the province in which the taxpayer resides.

Probate is a legal process whereby the courts of the subject taxpayer's province certify the validity of a taxpayer's will and the executor or executors appointed within that will. Most provinces charge a probate fee based on the value of assets to be passed through a taxpayer's will.

A strategy that can be used to reduce probate fees that will be imposed on a taxpayer's assets is the use of an alter-ego trust.

An alter-ego trust is a trust created by an individual 65 years or older under which the taxpayer is the only individual entitled to receive the income and capital of the trust during their lifetime. Assets are transferred to an alter-ego trust during the taxpayer's lifetime on a tax deferred basis and become assets of the trust. As such, the assets do not form part of the individual's estate and will therefore not be subject to probate fees. The assets will then flow to the named beneficiaries after the death of the settlor.

An alternative strategy that can be used to minimize or eliminate probate fees is the use of dual wills. To employ this strategy, a taxpayer segregates the assets of their estate into assets that will require probate such as publicly traded shares and assets that will not, for example, private company shares.

The taxpayer then establishes separate wills for each group of assets. The will which includes the assets subject to probate will be submitted to the courts but the will containing the other assets will be excluded.

As probate fees are based on the value of assets in the will that goes through the probate process, exclusion of certain assets from that will, will ultimately reduce probate fees otherwise applicable.

These strategies demonstrate how the structure of your will can be used to effectively reduce the tax liability imposed on the assets of your estate at death, and on income subsequently generated. Proper professional advice should of course be sought before implementing any of these strategies.

Ralph Rabinowicz is the Managing Partner;
Armando Iannuzzi is a Tax Partner and Jason Simon is a Tax Associate with KRP (Kestenberg Rabinowicz Partners LLP, Chartered Accountants, Markham, Ontario).