

Estate preservation and enhancement

March 2024

Jamie Golombek and Debbie Pearl-Weinberg

Tax and Estate Planning, CIBC Private Wealth



An estate plan sets out who you'd like to receive your property upon your death. Done properly, this plan takes into account how the various assets you own should be transferred so that as much of your estate value as possible is preserved for your beneficiaries. The estate plan may also consider how your estate could possibly be enhanced in value, through tax savings opportunities and the use of life insurance.

Income tax planning

Upon death, for tax purposes, all of your capital property is deemed to be disposed of at its fair market value. A capital gain or loss will be realized at that time on the difference between the fair market value of the property at the time of your death, and its cost. In addition, the fair market value of your registered retirement savings plan ("RRSP") and registered retirement income fund ("RRIF") is included in your income on death¹. You may, however, be able to defer this tax and preserve your estate value, depending to whom these assets are left.

Capital property received by your spouse or partner² — or certain trusts for their benefit — on your death may be transferred at cost rather than fair market value, thus deferring any capital gains and the associated tax liability until the death of the second spouse or partner, or until that spouse or partner sells the property.

¹ In some circumstances this may also occur where you are a member of a registered pension plan.

² In this article, spouse refers to someone to whom you are legally married. Partner refers to a common-law partner under the *Income Tax Act*, which means someone who cohabits with you in a conjugal relationship, provided the two of you have cohabited for the past 12 months or are jointly parents of a child.

Similarly, the income inclusion from an RRSP or RRIF can be deferred if the RRSP or RRIF is left to your surviving spouse or partner, who then uses a tax-deferred “rollover” to transfer the funds to their RRSP or RRIF. In this case, tax will only be payable by the survivor at the marginal tax rate in the year in which funds are withdrawn from the survivor’s RRSP or RRIF or upon their death.

Alternatively, an RRSP or RRIF may be left to your financially dependent child or grandchild and used to purchase a registered annuity that must end by the time they reach age 18. The benefit of doing this is to spread the tax on the RRSP or RRIF proceeds over several years, allowing the child or grandchild to take advantage of personal tax credits as well as graduated marginal tax rates each year until they reach 18. If the financially dependent child or grandchild was dependent on you because of a physical or mental disability, then the RRSP or RRIF proceeds can be rolled to the dependent’s own RRSP or RRIF. If you plan on leaving your estate to a number of different people, you may want to maximize the available rollover opportunities and leave other property, such as life insurance proceeds and GICs, to other beneficiaries.

Probate fee tax planning

In most provinces, probate fees, or estate administration taxes, are amounts paid in order to probate a will, which essentially certifies its authenticity. The amount of probate fees varies by province or territory, and generally is based on the value of an estate.

There are certain strategies that can be undertaken to reduce probate fees in certain circumstances. For instance, where a beneficiary designation is made on RRSPs, RRIFs or tax-free savings accounts (TFSA) or insurance policies, then the value of those assets typically flow outside of the estate and pass directly to the beneficiary and thus are not included in the value of an estate for probate purposes.³ Further, if assets are placed in a trust prior to your death, those assets also do not generally form part of your estate and will not require probate to pass on your death.

Although all strategies should be discussed with an external tax and legal advisor, some strategies can be particularly problematic. For instance, you may be tempted to put assets into joint names, with right of survivorship, since such assets typically bypass your estate. Before doing so, however, the legal and tax implications should be fully reviewed. Would the transfer result in a deemed disposition, causing capital gains taxes to be immediately payable? Could this transfer expose the assets to the claims of creditors of the adult child? Could it result in a dispute over ultimate inheritance of the property? The pros and cons of using a joint ownership strategy should be carefully evaluated, as in many cases, the probate fee savings may not be as significant as you think.

Strategic use of trusts

A trust is a relationship that separates the legal ownership of property from the beneficial use and enjoyment of that property⁴. Here are a few common uses of trusts in the context of estate planning.

Asset protection

A testamentary trust, which is created through your will, may assist with possible claims of third parties against your beneficiaries. When your beneficiaries inherit assets directly, the assets may become subject to certain legal claims. For example, if you leave assets to a beneficiary who later goes bankrupt, the inherited assets may become subject to claims of creditors of the beneficiary. Where the assets instead are left to a properly drafted discretionary trust for the benefit of that beneficiary, they may be sheltered from such third party claims.

Inheritance trusts

You may be concerned about how to provide for your spouse or partner, yet still preserve some of your estate for your children. This may be particularly relevant when you are in a new relationship. You could set up a spousal or partner trust in your will that specifies that income from the assets in your estate, or a portion of the assets, will be available to provide for the needs of your surviving spouse or partner during their lifetime, but

³ Beneficiary designations not permitted on certain types of RRSP, RRIFs and TFSA in Quebec.

⁴ A trust has a different characterization under Quebec laws.

that the remaining estate assets will ultimately go to your children upon your spouse's or partner's death. This can also be done with a trust set up during your lifetime.

Offshore inheritance trusts

Offshore inheritance trusts can provide a significant opportunity for tax savings if a foreign family member is planning on leaving assets to you, a Canadian resident, by way of a gift or inheritance. For example, suppose you live in Canada and expect to receive substantial funds from a parent who has always resided outside Canada. It may be possible for your parent to transfer the assets into a foreign trust without Canadian tax ever being levied on the trust assets or income. If the trust is located in a low or zero tax jurisdiction, there may be no tax anywhere on the annual income or growth of the inheritance. The transfer must be made directly from your parent to the trust; if you receive the funds first and then transfer them into an offshore inheritance trust, the tax-free benefits will not apply.

Estate freeze

If you have an incorporated business whose value has increased, an estate freeze may be a way to minimize taxes payable at the time of your death and thus preserve more of the value of the business for your beneficiaries. You can freeze the value of your holdings in the corporation at today's value, and, therefore, set the maximum gain subject to tax on your death. Any future growth in the business will be passed to others, and tax will be deferred on that growth until those others sell their interest, or until their death.

Life insurance

Life insurance can be used not only to preserve the value of your estate, but may also enhance the value of your estate beyond its current projected value.

Preserving estate value

You may wish to minimize the impact of any taxes payable on your death such that the tax liability does not erode the value of property that you would like to pass on to your beneficiaries. Similarly, you may want to make sure that beneficiaries are not forced to sell a particular asset, such as a cherished vacation property, if there is insufficient liquidity in your estate to cover capital gains taxes owing. You also might be concerned that your beneficiaries may be forced to sell property they inherit to make up for any loss of family income should you pass away. Finally, you may have a business which may require a cash infusion to continue in the short term should you pass away suddenly.

All of these costs could be funded with the purchase of permanent life insurance. In most cases, the death benefit associated with a life insurance policy can be received tax-free. As discussed above, by naming a beneficiary on the life insurance policy, you can generally exclude the value of life insurance death benefit from probate fees.

Enhance estate value

If you have funds that are not needed during your lifetime, and are available for investment, you may wish to consider purchasing a permanent life insurance policy. As stated above, the death benefit will not be taxable in most cases. In addition, investment income earned within most permanent life insurance policies is exempt from tax, which may lead to a higher after-tax return than investments which generate taxable income. You may also be able to deposit amounts into the policy that exceed the required premiums, which leads to additional tax sheltered growth.

This could enhance your estate value beyond what you had originally contemplated.

Example

Assume that Marie, aged 65, and Samuel, aged 67, who pay tax at the top Ontario marginal tax rate, have \$1 million to invest which they would like to leave to their children as part of their estate.

They are deciding between investing the funds in a GIC or in a joint (last to die) permanent insurance policy. One option they could consider using is a combination of these two options. They could invest the funds in a GIC, and withdraw amounts annually from the GIC to pay premiums on a Universal Life (UL) permanent insurance policy. Marie and Samuel will likely find that the amount available for their children on their death is higher using the combined strategy than simply investing in the GIC.

If you have an incorporated business, you may wish to employ this strategy with corporate owned life insurance.

Should you need income to support you during your retirement years, and wish to leave an inheritance to beneficiaries, you might also consider an “insured annuity” strategy, whereby you purchase an annuity and a permanent insurance policy rather than a GIC.

You can use the monthly tax-effective annuity payments to pay the insurance premiums, which can provide you with higher cash flow during your lifetime, while leaving the same amount to beneficiaries on your death if you had simply invested in a GIC.

U.S. estate tax planning

Finally, if you are not a U.S. citizen or other U.S. person, there could be U.S. estate tax upon your death if you own U.S. situs property — including U.S. real estate, U.S. business assets, U.S. securities and personal property located in the U.S. — depending on the value of those assets compared to the total value of your estate.

There are variety of strategies that you could consider to reduce exposure to U.S. estate tax, including investing in U.S. securities indirectly, such as via non-U.S. investment funds — for instance, Canadian mutual funds, segregated funds or exchange-traded funds — that hold underlying investments in U.S. securities, or incorporating your U.S. stock portfolio in a Canadian holding company. Similarly, you may wish to consider a trust to own your U.S. vacation property and also move valuables, such as artwork, antiques, jewelry or vehicles, out of the U.S. before death.

Summary

Many of the above noted strategies can be employed to assist with the preservation and even enhancement of your estate. Qualified legal and tax advisors should be consulted before incorporating these strategies into your estate plan.

Jamie Golombek, FCPA, FCA, CPA (IL), CFP, CLU, TEP is the Managing Director, Tax and Estate Planning with CIBC Private Wealth, Toronto.

jamie.golombek@cibc.com

Debbie Pearl-Weinberg, LL.B. is the Executive Director, Tax and Estate Planning with CIBC Private Wealth, Toronto.

debbie.pearl-weinberg@cibc.com

This report is published by CIBC with information that is believed to be accurate at the time of publishing. CIBC and its subsidiaries and affiliates are not liable for any errors or omissions. This report is intended to provide general information and should not be construed as specific legal, lending, or tax advice. Individual circumstances and current events are critical to sound planning; anyone wishing to act on the information in this report should consult with their financial, tax and legal advisors.

The CIBC logo is a trademark of CIBC.