WOOD GUNDY

ESTIMATING THE COST OF SETTLING YOUR ESTATE

Many Canadians fail to realize that death can trigger various taxes and other costs payable that may dramatically erode the value of their estate.

In retirement, you must first plan to meet your income needs for the rest of your lifetime and your spouse's lifetime. In addition to calculating income from company pension plans and government benefits, this involves taking an accurate inventory of your registered and nonregistered assets. With some strategic retirement planning, you should be able to maximize your after-tax income from these financial resources and support the retirement lifestyle you've always envisioned. Regardless of your relative wealth position, it is inevitable that you will begin to consider what will happen to your estate at your death.

This report concentrates on some of these major estate liabilities, such as income tax on registered plan assets, capital gains tax, U.S. estate tax, probate fees, estate administration fees, court fees, legal fees and funeral expenses. With proper planning, most of the "death taxes" may be delayed until the death of the surviving spouse. The terms spouse and commonlaw partner are used interchangeably throughout this report. Therefore, you should note that many of these estate liabilities primarily relate to either a single person or to a "second death" situation in the case of partners.

Your estate net worth position

At the end of this Special Report, you will find an Estate Net Worth Position worksheet that will help you project your estate net worth position at death. Once you have determined your total assets at death, including life insurance proceeds, you then subtract all of the projected liabilities that could fall to your estate at death to arrive at an estimate of your estate's true net worth.

You should be especially concerned about estate liquidity, particularly if you would like certain assets to be passed to your children without financial pressure to sell for estate liquidity purposes. For instance, you may want your children to keep the family cottage; however, if there is not enough cash in the estate to pay capital gains tax, or other taxes which may be triggered at your death, they may be forced to sell the property to raise the required cash for taxes.

Estate liquidity

Estate liquidity should be your first priority when planning your estate. This means ensuring that your current provisions will provide sufficient liquid assets at death to cover all of your liabilities at death. Although the current value of your estate may become significantly eroded after your liabilities are paid, you will not be leaving a financial or administrative burden to your heirs.

Estate preservation

Estate preservation may also be one of your goals. This means that you would like to keep the full value of your current estate intact, net of all liabilities at death. In order to achieve this, you will have to come up with additional liquid assets at death equal to all of your liabilities at death.

Estimating liabilities at death

We have included worksheets to help you make some rough estimates of your major income tax liabilities, probate costs and your net worth position at death. These worksheets ignore many rules and regulatory details that may apply to your situation and may greatly oversimplify some of the issues involved. Be cautioned that these worksheets are only meant to help you project ballpark figures for preliminary planning purposes. Before you attempt to complete any of the worksheets, here is a brief overview of some of the estate liabilities which could materialize at your death.

Your final tax return

Of all the certainties of life, the most frequently mentioned are death and taxes. Death is inevitable, but so are the taxes which will undoubtedly be collected. When you die, a final income tax return or "terminal year return" must be filed by the executors of your estate. All income earned from January 1st of the year of your death to the actual date of your death must be reported. The terminal year return is similar to the income tax return filed each year. Business, trust or "rights or things" income may be reported on separate tax returns if it is advantageous to do so. Also, the extraordinary taxes outlined below may be applicable to your situation.

Your CIBC Wood Gundy Investment Advisor can provide you with an estimate of your final year return using the FP Solutions "Simulated Terminal Return."

Tax on registered plan assets

RRSPs and RRIFs

Canada Revenue Agency (CRA) adds the full value of your RRSP/RRIF assets to your final year's income. If you have a spouse, the Income Tax Act allows a tax-free rollover of assets to your spouse's plan. Alternatively, the balance can be rolled into a registered plan for an infirm child or grandchild who is financially dependent on you. Or, if the beneficiary of the RRSP/RRIF accounts is a child or grandchild under age 18 and who was financially dependent on you (not due a physical or mental infirmity), then the balance can be rolled to a fixed-term registered annuity for the dependant to age 18. Otherwise, any payout is treated as a withdrawal and subject to tax reporting. Consequently, the value of your RRSP may be reduced by as much as 50% to satisfy this income tax liability.

Registered pension plans (RPPS)

Lump sum payments made after death are considered to be income for you or, in the case of a death benefit, for your estate or beneficiary. As such, they are subject to income tax, unless the lump sum amount is transferred directly to your spouse's RRSP. Amounts payable to beneficiaries other than your spouse are not eligible for a direct tax-free transfer to an RRSP. However, if the beneficiary is your child or grandchild, a lump sum payment may be rolled over into a fixed-term annuity ending when the beneficiary is 18, to average the tax liability over that period.

Tax-free savings account (TFSAS)

Upon your death, your estate is considered to have received an amount equal to the fair market value of all the property held in the TFSA immediately before death. Generally, the fair market value of the TFSA at date of death will be received tax-free by the estate, whereas all earnings that accrue after your death will be taxable to your beneficiaries, unless the payments made out of the TFSA to the beneficiaries do not exceed the fair market value of all property held in the TFSA at the time of death. For more information on TFSAs, please refer to our tax planning report, Tax Planning with TFSAs.

Capital gains tax

At death, you are deemed under the Income Tax Act to have notionally sold all of your assets at fair market value and this artificial sale could trigger a capital gains tax obligation. A capital gain occurs when an asset is sold (or deemed to have been sold) for more than its purchase price. Fifty percent of capital gains are included in your taxable income. When property is left to your spouse, the gain may be delayed until your spouse's death, at which point the entire capital gain will be taxed in your spouse's hands. Although there are no estate taxes or succession duties in Canada, the taxation of accrued capital gains on death is sometimes referred to as a "death tax".

The principal residence exemption

Normally, the capital gain in respect of your home is completely exempt from taxation because of the "principal residence exemption."

Recaptured depreciation

If your assets are depreciable in nature and you have deducted Capital Cost Allowance (CCA) with respect to these assets, the notional sale or "deemed disposition" of these assets on death could give rise to a recapture of CCA in your final tax return.

The lifetime capital gains exemption

An exemption of up to $750,000 of capital gains realized for certain types of property is available. Assets which are eligible for the exemption are Qualified Small Business Corporation (QSBC) shares and qualified farm property. To be considered as a QSBC, there are numerous tests to be satisfied. The tests are based on the manner in which assets owned by the corporation are utilized. These tests are quite technical and professional advice is mandatory. For example, with a QSBC, at least 90% of the corporate assets must be engaged in an active business.

If you own farm property, an interest in a family farm partnership, or shares in a family farm corporation when you die, the property may be transferred to a child, grandchild or great-grandchild through a partial or complete rollover with respect to all gains or losses.

The child must be a resident of Canada immediately before your death and the interest must be transferred or distributed to the child on or within 36 months after your death. If the property qualifies for a rollover to a child, the rollover may be preserved if the property is passed to a trust for your spouse when you die.

If the farm property meets the conditions for "qualified farm property" as outlined in the Income Tax Act, an exemption of up to $750,000 of capital gains realized may be claimed if the property is not rolled over and is disposed of, or deemed to have been disposed of, because of your death. Claims for a capital gains exemption may be reduced by a Cumulative Net Investment Loss, described on your annual notice of assessment from CRA as your CNIL balance. This only applies to 1988 and subsequent taxation years and only activates when you have a capital gain. This is an area of significant complexity and professional accounting advice is required.

Probate fees and estate administration tax*

After your death, the probate of your Will certifies that it is acceptable to the courts and confirms the authority of the executor named in the Will. Often an estate may be administered without the need for probate. Unfortunately, problems arise when just a single asset, even a minor one, requires the executors to take out letters probate. When this happens, all assets of the estate must be valued to determine the level of probate fees. However, some assets can pass outside the estate to reduce probate costs. Probate taxes or fees vary from province to province and there are many planning opportunities available to help reduce probate fees. For more information on probate costs, please refer to our Special Report, Maximize Your Estate by Reducing it for Probate Purposes.

Legal and executor/trustee fees

Some solicitors bill on an hourly rate basis and others on a percentage basis dependent on the value of the estate. It is important to discuss with your solicitor the manner in which he or she will bill your estate for services rendered in the administration of your estate. Similar discussions should also be held with your executors, particularly if nonfamily members are to be appointed. It is possible and even desirable, to enter into arrangements with your executors now (including family, nonfamily and institutional executors) on the manner in which executor and trustee fees will be levied. Such arrangements can also be incorporated into your Will. You should also be aware that some provinces provide guidelines for executors' and solicitors' charges.

*Probate fees are not applicable in Quebec

Funeral expenses

Every family and every situation is different; however, the average cost of a traditional funeral generally ranges from $7,500 to $20,000. Any funeral home should be able to give you an up-to-date list of funeral costs which could include funeral home facilities and equipment, professional services, automotive expenses, caskets, cremation costs, cemetery plots, grave opening and closing, vaults or urns, flowers, newspaper notices and clergy honoraria. Generally, monuments are separately provided by monument companies and they will quote their own various price ranges. Receptions after funerals are usually provided by the family and costs are largely dependent on the catering involved. Most funeral homes can help you prearrange a funeral according to your specific wishes and then file this information along with a general quote on what these arrangements should cost. In an effort to protect their estates from price increases, some people choose to prepay funeral costs.

Reducing and controlling the costs of settling your estate

You can do a lot to control and reduce the costs of settling your estate. It means planning for all expenses at death including funeral expenses, debt repayments, legal and probate costs. It also means arranging an orderly transfer of assets to your heirs and taking steps to minimize income taxes at death. For instance, you may wish to consider structuring an "estate freeze" through a holding company in order to crystallize capital gains at their current levels. You may also wish to consider incurring a capital gains tax liability now, by gifting or selling assets to your heirs. You may also wish to consider transferring assets to a trust. This may allow you to pass any subsequent growth on to your heirs. Such planning is highly technical, involving sophisticated transactions and complex income tax and non-income tax related considerations. Under no circumstances should you undertake to implement any such strategy without specialized tax and legal advice. You can always ensure estate liquidity and avoid estate shrinkage by providing funds to pay off liabilities that will exist at the time of death. Assuming you are healthy enough to be insurable, life insurance is well-suited for this purpose. If you are receiving more retirement income than you need, you may also be able to achieve estate maximization through various tax-efficient life insurance strategies.

Consolidating your assets

It is generally a sound practice to consolidate your assets during your retirement years. This should make it easier for you to structure your affairs and simplify the estate planning process. Consolidation generally means dealing with one trusted financial institution. Ideally, your investment advisor should help you manage your portfolio to ensure it meets your lifetime income needs and that it takes full advantage of "estate-friendly investments". This means structuring your assets so they will produce tax-efficient retirement income and provide estate liquidity. Your investment advisor should also be able to help you establish that beneficiary designations are current and accurate and that other estate planning and administrative details can be dealt with efficiently.

Estate planning is an ongoing process. Your estate plan should be reviewed frequently and remain flexible enough to accommodate unexpected changes in your financial or personal situation, as well as changes which are beyond your control, such as new legislative developments.

A CIBC Wood Gundy Investment Advisor is in a position to assist you in the estate planning process. He or she can help you to organize your affairs, identify your financial objectives, assist you with developing a plan and arrange for its implementation.

Estimating the costs of settling your estate is just one aspect of comprehensive estate planning. The comments offered here are meant to be general in nature and are not intended to proffer legal or tax advice. In addition, legislation in this area is continually changing. CIBC Wood Gundy is not a tax advisor and we recommend that clients seek independent advice on tax-related matters. Before taking any action, you must seek professional tax and legal advice to ensure that your planning strategies are appropriate to your personal circumstances, that they are effective in the jurisdiction in which you reside, and that no negative income tax or family law implications will arise.

Estimating major income tax liabilities at death

Single Taxpayer or "Second Death" Scenario (Upon the death of the first spouse, it is assumed that tax-free rollovers will be utilized by the second spouse; thereby deferring many tax liabilities until the death of the second spouse).

Tax liability on registered plan assets

At death, the full value of a Registered Plan becomes taxable income. Use the table below to estimate the tax liability on registered assets.

Assume a personal tax rate of: ______%

Assets	Current value	Estimated tax payable
RRSP/RRIF		
TFSA		
RPP lump sum payments/death benefits		
Total		

Tax liability on deemed disposition of all non-registered capital property at death

Use the table below to estimate the tax liability resulting from the deemed disposition of all non registered capital property at death.

Assume a personal tax rate of:______%

Assets	Fair market value	Adjusted cost base	Recaptured CCA	Capital gains	Taxable capital gains (50%)	Estimated tax payable
Stocks, bonds						
Other securities						
Qualified small business corporation shares						
Personal use property**						
Listed personal property***						
Principal residence (usually tax exempt)						

Assets	Fair market value	Adjusted cost base	Recaptured CCA	Capital gains	Taxable capital gains (50%)	Estimated tax payable
Vacation properties						
Investment properties						
Qualified farm property						
Land for personal use						
Total						

*Capital Loss Allowance.
**Includes items such as cars.
***Includes items such as art and jewelery.

Estimating probate fees and estate administration tax

Assets	Current value	Beneficiary designation?*	Joint tenants with right of Survivorship?*	Value of estate for probate purposes
Registered assets				
RRSP/RRIF		Y ☐ N ☐		
TFSA		Y ☐ N ☐		
RPP lump sum payments/ death benefits		Y ☐ N ☐		
Non-registered assets				
Guaranteed income annuities		Y ☐ N ☐		
Other income securities			Y ☐ N ☐	
Growth securities			Y ☐ N ☐	
Real estate (net or debt)				
Principal residence			Y ☐ N ☐	
Vacation properties			Y ☐ N ☐	

Assets	Current value	Beneficiary designation?*	Joint tenants with right of Survivorship?*	Value of estate for probate purposes
Investment properties			Y ☐ N ☐	
Farm properties			Y ☐ N ☐	
Land for personal use			Y ☐ N ☐	
Other				
Other:		Y ☐ N ☐	Y ☐ N ☐	
Total				
Estimated probate fees or estate administration tax**				

*Generally, when answering "Yes" to either "Beneficiary Designation?" or "Joint Tenants With Right Of Survivorship?" you may exclude the value of these assets from the value of estate for probate purposes.
**Estimated probate fees or estate administration tax are based on the total of "Value Of Estate For Probate Purposes" and may vary from province to province, please contact your CIBC Wood Gundy Investment Advisor for more information.

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