

THE ESSENTIAL CHECKLIST FOR AN EFFECTIVE ESTATE PLAN

By Heather G. Hisey, LL.B. and members of the Private Client Group, Torys LLP

Masters Series

This is one of a series of articles prepared for CIBC Private Wealth Management™. The series is written by professionals in such fields as taxation, trusts, and estates.

A surprising number of Canadians — including many with substantial assets and complex family, business, or professional situations — do not enjoy the peace of mind that comes from having an effective estate plan in place. An estate plan must be properly executed, and based on a full understanding of an individual's lifestyle, wishes, and overall family and financial situation.

It is not an impossible challenge, however. In the following article, we provide a checklist for you to review with your advisors, to ensure that your own estate plan is as effective as possible.

1. Establish your objectives

The principal objective of estate planning is to arrange for your assets to be transferred upon your death to your heirs as quickly and tax-efficiently as possible. This objective is accomplished through your will and through arrangements made during your lifetime.

Common planning techniques include lifetime gifting programs and the use of inter vivos trusts and corporate reorganizations to “freeze” the value of your significant assets and the consequential capital gains tax arising upon death. These are discussed in more detail later.

The planning techniques that are appropriate for you will depend on the

types of assets you currently own, their potential tax exposure upon your death, and who you want to receive them. If you have dependants, you have a legal obligation to support them. There may be charities or friends that you wish to benefit from a portion of your estate. If you own a business, you need to consider whether it should be sold or whether your spouse or one of your children should carry on in your place.

Your objectives will be unique to your family and your circumstances. What's important is to identify them so you can take steps now to achieve them after you're gone.

2. Make a will

A will is a document that contains a declaration by a person (called a testator) as to how he or she wants his or her property dealt with on death. A will is the foundation of any estate plan. An effective will determines the orderly administration and disposition of your assets after your death, according to your wishes.

If you die without a will, the court will appoint someone to administer your estate.* Provincial government legislation will determine who will receive your property and what they will receive.

If you are over the age of majority

(18 or 19, depending on the province), you should have a will. A will ensures that the persons whom you wish to benefit actually do benefit to the extent and in the manner that you wish. It also enables you to select the person you wish to administer your estate.

Once a will is complete, it should not be put away and forgotten. Whenever there is a substantial change in your circumstances (such as an increase or reduction in assets or the death of an estate trustee or beneficiary), your will should be reviewed and possibly updated. As well, if you marry, your existing will may be revoked.* In any event, you should make a point of reviewing your will every year or two, to ensure that it continues to address your needs and wishes.

3. Select an estate trustee

An estate trustee* (also called an executor, administrator, or liquidator, depending on the province) is a personal representative chosen by you and specified in your will to carry out its terms.

The role of the estate trustee is to wind up the affairs of the deceased. The estate trustee collects, manages, and invests the assets as required, pays debts, and then distributes the assets to the persons entitled to them (the beneficiaries). The estate may be immediately distributable, or it may require that some or all of the property be held in trust for a period of time. The estate trustee is responsible to the beneficiaries of the estate.

The role of the estate trustee is onerous, and the choice requires careful consideration. In the event that your original estate trustee becomes unable to carry out his or her duties, a well-drawn will typically provides for the appointment of replacement estate trustees, to ensure that there is always someone of your choosing available to act.

A testator may appoint a trust company as an estate trustee. There are advantages and disadvantages to this. A trust company may provide a higher level of experience in matters of investment, estate accounting, and other estate administration tasks and may have greater resources than most individual estate trustees. A trust company also offers permanence, which may be desirable if the will provides for trusts of potentially long duration.

On the other hand, trust companies are sometimes perceived as inflexible and less responsive than individual estate trustees. A testator may appoint a trust company and an individual to serve as co-trustees.

4. Take appropriate steps to reduce probate tax

Probate is the process by which the court certifies that an individual (a legal personal representative) has the right to administer the estate of a deceased person. With the exception of Quebec,* probate fees are levied by the provincial governments for granting a Certificate of Appointment of Estate Trustee or Letters Probate (the terminology varies).

Probate taxes or fees vary considerably across the country. Ontario and British Columbia generally charge the highest (approximately 1.5% and 1.4% of the estate's value, respectively), while the maximum in Alberta is just \$400, regardless of the size of the estate. Depending on your province of residence, reducing or avoiding probate fees may be an important element of estate planning. Several basic planning techniques are summarized below.

Holding assets jointly. If an asset is held jointly by two individuals with right of survivorship,* then title to the asset will pass to the surviving joint owner immediately on the death of the first joint owner. The asset does not form part of the deceased joint owner's estate and probate fees are not levied on the value of the jointly held asset.

Transferring property into joint names has some potentially undesirable consequences, however. If the title to property is transferred into joint names, the former sole owner generally relinquishes his or her right to dispose of the property. In addition, transferring the property may result in an immediate income tax liability.

Naming beneficiaries. If an insurance policy designates a beneficiary other than the estate of the individual whose life is insured, then the proceeds pass directly to the designated beneficiary on the death of the insured individual and do not form part of the estate of the deceased. The amount of the insurance proceeds is not included in the calculation of probate fees. The same concept applies to Registered Retirement Savings Plans, Registered Home Ownership Plans, and Registered Retirement Income Funds, as well as profit sharing, retirement, and pension plans.*

Transferring assets to a trust. Property that is transferred to a trust during an individual's lifetime ceases to belong to the individual and does not form part of his or her estate on death. The value of the assets transferred is therefore not subject to probate fees. Transferring assets to a trust may trigger adverse income tax consequences, however. It is important to receive appropriate tax advice if you wish to use a trust as part of a strategy to avoid probate fees.

Lifetime gifts. Lifetime gifts can also reduce the value of an individual's estate and the probate fees payable. By gifting, however, the individual relinquishes all control over the gifted property and may incur an immediate income tax liability.

Multiple wills.* If the assets of an estate can be distributed without probating the will, no probate fees will be payable. Generally, probate is not required to transfer personal and household articles or shares in a private corporation. An estate may benefit from the preparation of two wills: the first will would include any personal and household articles and any shares in a private corporation; the second will would include the remainder of the estate. Probate fees would be payable only on the value of the assets included in the second will.

5. Explore the advantages of an estate freeze

The following example illustrates a basic estate freeze:

Ms. Freeze is 65 years old and married, and has two children and three grandchildren. She has spent many years building a manufacturing business in Canada. Her wholly owned company, FreezeCo, is currently valued at \$10,000,000 and is expected to enjoy explosive growth in the next five years. She is concerned about the amount of capital gains tax that will arise on her death, and the ability of her estate to fund that tax liability.

The following plan is implemented. The shares of FreezeCo are changed from ordinary common shares to fixed-value preferred shares, which are redeemable for \$10,000,000 at the option of Ms. Freeze. Ms. Freeze subscribes for a special class of voting shares that carries the ability to control FreezeCo. A trust is established for the benefit of Ms. Freeze's children and grandchildren. The trust acquires new common shares of FreezeCo so that the benefit of the future growth in the value of FreezeCo will be available for Ms. Freeze's children and grandchildren through their interests in the trust. On Ms. Freeze's death, a capital gain will be recognized only on her preferred and voting special shares of FreezeCo.

6. Draw up a power of attorney for property

Powers of attorney* are an important component of any plan. A power of attorney for property allows an individual (called the donor) to appoint another individual

(called the attorney) to make decisions about the donor's financial affairs.

A major advantage of a power of attorney for property is that it enables the attorney to manage and make decisions about the donor's financial affairs if the donor loses the capacity to do so. Powers of attorney are generally drafted to take effect when signed and, if drafted properly, remain effective after the donor becomes incapacitated. If there is no power of attorney in effect, the individual's family must endure a time-consuming and expensive court process to obtain permission to manage the incapacitated person's financial affairs.

Powers of attorney may be specific (such as the authorization to complete a real estate transaction) or general (such as the authorization to do anything that can be done by the donor). Although donors sometimes appoint their lawyers as attorneys, it is more common for the attorney to be a trusted relative (the donor's spouse, adult child, parent, or other close family member), colleague, or friend. A trust company may also be appointed as an attorney either solely or jointly with the trusted relative.

7. Make a power of attorney for personal care

A "power of attorney for personal care"* relates to a person's health care (including his or her right to consent to or refuse medical treatment), nutrition, shelter, clothing, hygiene, and safety. These documents are also known as "health care directives" or "living wills." Note that they are not formally recognized in all provinces and therefore may not be legally enforceable.

Generally, such powers of attorney empower the attorney to make decisions about the donor's health care (including the right to consent to or refuse medical treatment, if the power of attorney expressly states this right), nutrition, shelter, clothing, hygiene, or safety at any time when the donor is unable to make such decisions for himself or herself.

8. Deal with U.S. tax issues

Many Canadians have ties to the U.S. These ties may include residential connections, ownership of U.S. assets (including shares of U.S. corporations), and family members who are citizens or residents of the United States. Many Canadians are unaware, however, that these ties may bring them into

contact with the U.S. transfer tax system and that U.S. estate tax may be payable on their death.

For example, Mr. Investor is a Canadian citizen and resident who holds investments of U.S. companies. His total investment is valued at \$10,000,000. If the investments are held directly by him on his death, significant U.S. estate tax could be payable. Transferring the U.S. investments to a private Canadian holding company should avoid U.S. estate tax altogether.

Estate planning is a complex area involving the law of wills, trusts, powers of attorney, and Canadian and U.S. tax. Legislation varies from province to province, and is subject to change. For advice pertaining to your specific circumstances, always consult a qualified professional. As well, any references in this article to Canadian tax matters are based on federal tax laws only, unless otherwise stated. Provincial tax laws may also apply and may differ from federal tax laws.

*Estate Planning in Quebec

In Quebec, there are some differences in estate planning due to variations in the applicable laws in that province. If you die without a will in Quebec, your heirs or the court will appoint someone to administer your estate. In Quebec, marriage will not revoke a will, but will make the estate subject to the matrimonial regime selected and the family patrimony rules. An estate trustee is known as a liquidator and powers of attorney (both for property and for personal care) are known as mandates.

Probate fees are not applicable in Quebec and as a result, probate planning techniques are neither relevant nor necessary. More specifically, joint ownership with a right of survivorship is not available. Beneficiary designations on pension plans are available only in certain, limited circumstances. Multiple wills are not applicable.

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