

# WILLS & ESTATES PLANNING GUIDE

## Death, Taxes & Estate Planning

“There is no avoiding death or taxes”. Actually, there are some taxes you can avoid and others that you can reduce or delay.

Estate planning is more than making a Will. Estate planning is process of preparing a plan for looking after your family and dealing with your assets and liabilities after your death. Estate planning also involves taking steps to try to minimize the amount of tax that is triggered by your death.

## Assets, Liabilities & Net Worth

You should start by considering what your net worth is today and your plans for the future. Prepare a balance sheet of what you own and what you owe, include any property that you own jointly with your spouse or other people. Also make a list of any life insurance policies you have (including life insured mortgages or loans), RRSPs, pensions entitlements and other money or benefits that may be available after your death.

## Needs and Wants

If you have dependents (spouse, children, parents or others that rely on you for living expenses) then you must consider what your family's financial requirements are from month to month and in the long term (education costs for children, retirement planning, etc.) and what your family would need to cover their expenses if you died. Review what income would be available, including Canada Pension Plan, other pension income, RRSPs, life insurance, investments, etc.

You may need to purchase more life insurance or you may find that you can safely reduce the amount you currently spend on life insurance.

If you do not have dependents, or they will be provided for then you may also consider if there is anyone you want to provide a benefit for after your death, such as a charity.

## Five Types of Assets & Your Will

You may be surprised to learn that your Will may not control how your net worth is distributed on your death. People generally have five types of assets that are distributed after death, and only one type is controlled by your Will (your “Estate”).

- **Estate.** Your Estate consists of everything you personally own, other than property you own jointly with your spouse or others. Typical assets of your estate are real estate, vehicles, bank accounts (unless owned jointly - see below), investments & mutual funds (other than those held jointly or in a registered account (RRSP/RRIF) - see below), household furnishings, recreational equipment, clothing and personal effects. Your estate will also include life insurance proceeds and your RRSP/RRIF if no beneficiary has been named, if the named beneficiary(ies) have all died before you or if you have expressly named your estate as the beneficiary.

- **Joint Property.** Anything you own jointly with your spouse or other people does not become part of your Estate and is not controlled by your Will. Joint property automatically becomes the property of the surviving joint owner(s) when one of the joint owners dies (referred to as the “right of survivorship”). No transfer forms are necessary, although the land title office, bank or vehicle registry will need proof of the death of the joint tenant to update their records of ownership. Typical joint property includes the family home which is usually owned jointly by the spouses, and joint bank accounts. The ease in which joint property automatically passes on death makes it a popular estate planning tool.

Note that property can be owned by two or more people in two distinct ways, as Joint Tenants or as Tenants in Common. Owning as Joint Tenants creates the right of survivorship and is the typical way spouses own their property. If property is owned as Tenants in Common, the right of survivorship does not exist and the deceased person's share of the commonly owned property becomes part of his or her estate. This is often used in commercial circumstances where two unrelated business partners own a rental property together.

- **Life Insurance.** Typical life insurance is known as “term” life insurance. It is only in place for the period of time you pay for - the term. It is similar to your home and auto insurance.

Another common life insurance product is known as “whole life” or “universal life” insurance. Whole life and universal life policies are more complicated and expensive than term policies. They usually involve a savings component. Their treatment on death depends on the specific provisions of the policy but are generally treated the same as term policies.

Term life insurance is not really an asset of the deceased but rather a contract with an insurance company who has agreed to pay your named beneficiaries a certain amount on your death. The proceeds of your life insurance are paid directly by the life insurance company to your named beneficiaries after your death (unless your named beneficiaries have all died before you, you have failed to name a beneficiary of your policy or you have expressly named your Estate as your beneficiary). Typically all the life insurance company needs are a death certificate, proof of the identity of the named beneficiaries and an application form.

Your life insurance will be an asset of your Estate and administered by your Executor in accordance with your Will if all of your named beneficiaries die before you, you have failed to name a beneficiary of your policy or you have expressly named your Estate as your beneficiary.

Some life insurance policies name your bank as the beneficiary and will pay out your mortgage or another loan on your death.

## Tax Planning

Canada does not currently have an inheritance tax (many US states do) but there are three ways that your death can trigger a portion of your estate flowing into government coffers - 1) Probate Fees, 2) Income Tax on RRSPs and 3) Capital Gains Taxes.

- **Probate Fees.** British Columbia has a probate tax that is charged on your estate assets when your Executor submits your Will for Probate (the process where the court confirms that the Will is valid and binding). The fee depends on the size of your estate (for estates worth more than \$50,000 the fee is \$358 plus 1.4% of the value of the estate in excess of \$50,000). The Probate tax can be reduced or eliminated by minimizing the amount of property that flows through your estate (there is no tax on jointly owned assets or life insurance/RRSP/RRIF going directly to a named beneficiary). For example, if you live in British Columbia, are married and your main assets are your family home worth \$250,000 and a \$250,000 life insurance policy then your spouse will save approximately \$7,000 in probate fees if you own your home jointly with your spouse and name him or her as the beneficiary of your life insurance policy.
- **Registered Accounts - RRSP/RRIF.** RRSP/RRIFs are a great way to reduce taxes and save for retirement. However, RRSP/RRIFs defer the payment of taxes, not eliminate it. When money is withdrawn from an RRSP/RRIF it is brought into income in the year it is withdrawn. When someone who owns a RRSP/RRIF dies, the whole amount of their RRSP/RRIF is brought into income in the year of their death. This can create a large tax bill that can consume up to 43.7% of the RRSP/RRIF (2004 tax rates).

There is relief in the form of a spousal roll-over. Instead of collapsing the RRSP/RRIF and bringing it into income, the RRSP/RRIF account can be rolled over into an RRSP/RRIF in the name of the spouse of the deceased person. This will prevent the large tax bill in the year of death. The payment of taxes will be deferred until the spouse dies or withdraws the money themselves. There is also a limited roll-over provision for dependent or disabled children.

- **Capital Gains.** Capital assets (such as investment property, rental real estate, stocks or mutual funds held outside of an RRSP) that have increase in value are taxed when they are sold. Capital Gains Tax is paid on the amount the asset increased in value. The Income Tax Act creates a deemed disposition on death. It is as if the deceased person sold all their assets to their estate at fair market value on the day they died. Capital Gains taxes have decreased over recent years (down to 21.85% in 2004) but this can still cause a large tax burden for the estate. Normally the capital asset can be sold to pay the capital gains taxes.

Capital assets can be rolled over to a spouse so that the tax is deferred until the spouse sells the property. This can be done if the asset is part of the estate and the spouse is named as a beneficiary of the deceased's Will. There is no capital gains tax on family home.

- **Registered Accounts – RRSP/RRIF.** Registered accounts are set up in accordance with the Income Tax Act as a retirement savings tool. You contribute to your Registered Retirement Savings Plan (RRSP) during your income earning years. You must convert your RRSP to a Registered Retirement Income Fund (RRIF) by the time you turn 69 and start pulling the money out (you can voluntarily take money out of your RRSP at any time before 69, however after 69 it is mandatory).

RRSP/RRIFs are a trust. Your financial institution holds the investments in trust for you and your named beneficiaries. If you die before using up your RRSP/RRIF then the balance is paid directly by the financial institution to your named beneficiaries (unless your named beneficiaries have all died before you, you have failed to name a beneficiary of your RRSP/RRIF or you have expressly named your Estate as your beneficiary). Typically all the financial institution needs are a death certificate, proof of the identity of the named beneficiaries and an application form. Due to the tax impacts of collapsing a RRSP/RRIF account, the financial institution may also hold back a portion of the proceeds until your Estate's taxes are done (the tax impacts of death on RRSP/RRIFs will be discussed more below).

Your RRSP/RRIF will be an asset of your Estate and administered by your Executor in accordance with your Will. If all of your named beneficiaries die before you, you have failed to name a beneficiary of your RRSP/RRIF or you have expressly named your Estate as your beneficiary.

- **Pensions.** Canada Pension Plan and most other government, union and private pensions have survivor rights. Your spouse (and possibly your dependent children) may be entitled to monthly income in accordance with the pension plan rules. If the pension has a lump sum death benefit, it is usually payable directly to your spouse or your estate.

## Your Estate Plan

It should now be clear that your Will is only part of your Estate plan. It is critical to review all of your assets and how they will be distributed on your death. In particular, we recommend that you:

- Check the beneficiary designations for each of your life insurance policies, RRSP/RRIF accounts and pension death benefits. Married or common law couples should name their spouse as their beneficiary.
- Check how your major assets are owned. Most married or common law couples should own all of their major assets (including their home, bank accounts, vehicles and other financial assets) as joint tenants, unless there is a good reason not to (sometimes assets are held in one spouse's name for insurance reasons, to allocate income to the spouse with lower taxes, for creditor protection or other reasons).