



*Top 10
things to
consider
for your
will and
estate
plan*



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1 Plan to fund the deemed disposition tax that will arise on your death and defer the tax with a spousal rollover

- Subject to certain limited exceptions, an individual is deemed to dispose of all assets for fair market value proceeds upon death:
 - Capital gains and losses will be triggered and tax will be payable on the net capital gains—top tax rate is 23.21% in Ontario
 - Your estate can make an election to pay the tax over 10 years—but interest will be charged at the prescribed rate + 4%, which is not tax deductible
 - Without proper planning to fund the tax, your family may need to sell your business to pay the tax
- For example, if your shares have a value of \$10 million and a nominal cost, the deemed disposition tax could be as much as \$2.32 million
- If you have a spouse or a common law partner who survives you, the tax can be deferred if your will transfers your assets:
 - to your spouse or partner directly, or
 - to a “spousal trust” for the benefit of your spouse or partner

The tax is deferred until the earlier of the assets being sold or the death of your spouse or partner
- If you use a spousal trust:
 - your spouse or partner must be entitled to receive all income earned by the trust, and
 - no one else can receive or obtain the use of any income or capital of the trust while your spouse or partner is alive
 - avoid the traps that can taint the spousal trust!

2 Consider a flexible estate freeze to prevent tax liability from increasing

- The deemed disposition tax arising on your private company shares will increase as the value of your business increases—so the tax could be as much as:
 - \$2.32 million if the capital gain on your shares is \$10 million
 - \$4.64 million if the capital gain doubles to \$20 million before your death
- An estate freeze of your company can prevent your tax from increasing over time
- An estate freeze generally involves an individual exchanging their common shares for preferred shares that have a fair market value equal to the value of the common shares
- A valuation is required
- The estate freeze structure can be very flexible:
 - You can control your company after the freeze
 - The new common shares can be owned by a trust for the benefit of you and your family members for almost 21 years
 - You can be one of the trustees of the trust
 - You can potentially share in the future growth after the freeze
- The estate freeze structure can facilitate income splitting with adult children and possibly your spouse if they have nominal income
- Once the value of the company is determined for the estate freeze, you can plan to fund the deemed disposition tax, which should not increase if you do not share in future growth

3 Consider a redemption strategy after the freeze to reduce tax on death

- A flexible estate freeze can prevent the death tax from increasing
- The deemed disposition tax can be reduced and possibly eliminated by redeeming a portion of your preferred shares after the estate freeze as you require funds, instead of paying bonuses or dividends
- For example, assume you freeze your company at a value of \$20 million—your tax on death will be as much as \$4.64 million:
 - if you receive an annual dividend of \$500,000 on your preferred shares, you will pay tax on the dividend of up to \$162,850 and your death taxes will not be reduced
 - if instead \$500,000 of your preferred shares are bought back by your company, you pay the same tax—but your death tax will be reduced by \$116,000—and by \$1.16 million after 10 years

4 Plan to use your capital gains exemption and to use exemptions of family members

- The use of your lifetime capital gains exemption (“LCGE”) of \$750,000 can reduce tax payable:
 - on a sale of your shares, or
 - when your shares are subject to the deemed disposition on deathby \$174,000 if your shares qualify
- An estate freeze may allow you to multiply the use of the LCGE:
 - the use of 3 family members’ LCGE can shelter future capital gains of \$2.25 million from tax—saves tax of up to \$522,000
- Planning the structure is important to ensure your company will qualify for the LCGE and to multiply the use of the LCGE

5 Plan to avoid double tax on your private company shares

- Any time an individual dies owning shares of a private company, there is an exposure to double tax:
 - once when the deemed disposition arises on their shares on death, and
 - again if the company disposes of its appreciated assets and distributes the proceeds to the shareholders
- Double tax exposure may not exist if you directly own shares of your operating business
- Double tax planning will likely be required if you own shares of your operating business through a holding company or have investment assets or real estate in your company
- The most common plan to avoid double tax must be completed by the executors of an individual's estate
 - within 1 year after the individual's death
- If your will transfers your shares to a spousal trust, the trust should be drafted to provide for its continuance for up to 3 years after your spouse's or partner's death
- Certain powers should be included in your will to enable your executors to complete double tax planning transactions, including power to:
 - incorporate new companies and transfer assets to private companies
 - wind-up private companies and to have private company shares redeemed, and
 - power to make tax elections
- The executors should be advised that planning transactions will be required after death to avoid double tax and to seek tax advice

6 Create trusts in your wills to reduce tax payable by your beneficiaries

- Instead of leaving inheritances directly to your spouse and children, consider creating separate trusts in your will for their inheritance:
 - this strategy can save tax each year of up to \$16,000 for each beneficiary even if the beneficiary receives all of the income
 - the use of trusts may also facilitate creditor protection and protection on a breakdown of a beneficiary's marriage—legal advice should be obtained
 - accounting records and a trust tax return will be required annually
- If you will be receiving a significant inheritance from a parent, these same advantages are available to you if your parent creates a trust in their will for your inheritance

7 Plan the ownership of your assets and your wills to minimize Ontario probate fees

- Ontario Estate Administration Tax (probate fees) is generally payable at a rate of 1.5% on the value of assets under a will that must be probated
- There is no spousal rollover—double probate may apply without planning. Consider:
 - owning home jointly with the right of survivorship with your spouse to avoid double probate (subject to creditor concerns)
 - using a spousal trust to avoid double probate on investment assets
- Consider the use of multiple wills for your private company shares and receivables to avoid probate on these assets
- Consider named beneficiaries of insurance proceeds or create an insurance trust in your will to avoid probate on insurance proceeds
- Similar planning should be considered by your parents

8 Structure donations in your will to ensure the tax benefit can be claimed

- Charitable bequests can offset 100% of net income in the year of death and year preceding death if structured properly. Common traps:
 - donations not meeting the technical requirements of the Income Tax Act
 - the donation tax credit is not matched with the tax on death—this may be an issue if you hold the shares of your business or investment assets through a holding company, and
 - donations made from the spousal trust after spouse dies is not structured to qualify for a donation tax credit
- If your Will makes a donation to registered charities, include a power allowing executors to donate in cash or in kind:
 - this allows public company securities to be donated to charities to take advantage of the nil capital gain inclusion rate

9 Determine if you are exposed to U.S. estate tax

- Special planning may be required if:
 - You are a U.S. citizen or you hold a U.S. green card
 - Your spouse or common law partner is a U.S. citizen
 - You have children who are U.S. citizens or who live in the U.S., or
 - You own U.S. situs assets, such as real estate in the U.S. or shares of U.S. corporations
- U.S. citizens are subject to U.S. estate tax on the value of their worldwide assets
- Non-U.S. citizens are subject to U.S. estate tax only on assets situated in the U.S., such as U.S. real estate and shares of U.S. corporations

New US Rules – Passed December 17, 2010

US Estate Tax – Reinstated through 2012

- \$5M exemption for estate, gift & generation skipping tax
- 35% tax rate

Starting 2013 (if no government action)

- \$1M exemption for estate, gift & generation skipping tax
- 55% rate

You should seek U.S. advice if you are a U.S. citizen or U.S. green card holder, you are married to a U.S. citizen, you have children who are U.S. citizens or who reside in the U.S., or if you hold U.S. situs assets

10 Consider the non-tax implications of your estate and will plan

- Have you developed a contingency plan in the event of an untimely death?
- Do you have an exit strategy for the business, whether it is to:
 - sell to a third party purchaser or to management, or
 - to transfer your business to your family?
- If you plan to transfer your shares to your family:
 - have you identified your successor?
 - have you discussed this with your family?
- Have you thought through how your estate assets will be divided among your family members and are they “packaged” so this division can be achieved?
- Does your will meet your intentions with respect to the division of your assets and your other objectives?

Conclusion

Planning today can:

- Reduce taxes during your lifetime
- Minimize income tax and Ontario probate fees arising on death
- Minimize the tax payable by your beneficiaries on income earned on their future inheritance
- Result in an orderly transition of your business, and
- Ensure that your estate planning objectives will be met

Contact

Kathy Munro

kathy.m.munro@ca.pwc.com

416 218 1491

www.pwc.com/ca/private