

Draft client's will to 'disinherit' the tax collector

Whenever you are drafting a will, there are a number of client-focused tax reduction strategies that deserve careful consideration. Clients who have accumulated and secured their assets through hard work typically have managed their affairs to keep taxes to a minimum. They are financially savvy and yet many people still end up with wills that include an unexpectedly significant heir: the tax collector.

A review of your clients' financial holdings — in combination with any legal agreements that take effect on death to develop a projection of what their estate will look like — can be an eyeopener.

The result is your clients coming to understand that while they have three children they thought of as their beneficiaries, they really have four; their children and the tax authorities.

Will your clients resist strategies to reduce taxes in their estate? Not if you help them envision the taxman sitting at the table with their children at the reading of their will.

Informing your client that 20 per cent of their five-million dollar estate will go to Canada Customs and Revenue Agency (CCRA) and provincial tax coffers can be very motivating information.

Knowing this will help them make informed choices about what their will should contain, as well as steps they should consider taking now to produce a better result for everyone.

Occasionally, clients not motivated by this type of information simply need it presented another way. "How long did it take you to make your first million? Do you really want to give this to the government?"

On the flip side, omitting this analysis could produce a seriously misdirected result when their will goes into effect. We all know the stories of the family business left with a staggering income tax bill, the bank loans that suddenly became due, forcing the sale of valuable assets, or the spouse whose standard of living was not fully protected.

Financial advisers and estate planners know that a lack of assets may be difficult to manage, but assets should never be eroded due to a lack of planning.

Leave the taxman weeping

How do you disinherit the taxman? There are a number of financial structures and strategies legal counsel can use to benefit heirs through reduced taxes. Some



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of these strategies must be implemented during the lifetime of the testator, not just at the moment of executing the will.

Testamentary trusts

Making a testamentary trust available in your will can protect assets as well as offer long-term tax savings. CCRA views this type of trust as a separate taxpayer, thereby providing income splitting opportunities.

We often hear a concern about probate tax when discussing this type of strategy, as the assets must go through the estate and, potentially, probate to be settled into the trust. The important issue clients can lose sight of is that the tax savings in the trust occur every year the trust exists and frequently offset the probate, or estate administration tax, quickly. The trust remains to generate tax savings and provide more cash flow to the beneficiaries for many years. The probate process may be avoided if the source of the trust funds is a properly designated insurance contract.

Estate freeze

Now a highly refined art in the professional community, an estate freeze can cap the amount of capital gains tax due when the assets are passed between generations. This strategy can be quite powerful when combined with a share redemption plan.

Consider the example of a couple writing their wills. Both are 65 years old. They have two adult daughters and own a company worth \$5 million. It is anticipated that they will only need about one-third of this value and they are willing, therefore, to pass the future growth of these assets to their children.

By capping their entitlement to today's

value — freezing their interest — no additional capital gains tax will be due to the tax authorities when the company is passed to their children. In addition, supplementing their retirement income by the redemption of the "frozen" shares over a number of years provides the needed income while buying down the capital gains tax bill that already exists.

Up-to-date documentation

Legal agreements that your client has previously entered into may have death clauses. These must be reviewed and integrated into the financial review. In some cases, the agreements may need to be updated. A buy-sell agreement, for example, may be outdated or could be restructured to provide a better tax result if tax laws have changed.

A caution is warranted here: care should be taken not to disturb an agreement that provides benefits that can no longer be obtained under current tax law. The goal is to update documents to save taxes, not to incur new ones.

Alter ego and joint partner trusts

Some clients can benefit from the careful use of an alter ego or joint partner trust. While best used in very specific circumstances, this strategy can assure the passage of assets where the settlor of the trust intends and can remove these assets from the probate process, saving estate administration tax.

Spend smart

Determining in what order to consume assets during retirement years also can provide significant estate-planning benefits. It may be counter-intuitive, but the most highly taxed are sometimes the best assets to use first. While this may require restructuring asset holdings and sources of income, drawing on RRIFs that are destined to be subject to significant tax either on withdrawal or on death can leave other less heavily taxed assets for family.

The important issue here is that a full understanding of your clients' goals and financial assets is essential to determining the best steps to keep the taxman from their door. Even clients who want to "keep things simple" will find some combination of these strategies attractive when presented with the cost of not implementing any of them.

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