



COMMENT

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JOINT AND SEVERAL LIABILITY

A recent court case, *Curley v. MacDonald*, highlights an interesting planning point with respect to beneficiary designations on registered retirement savings plans (RRSPs).

The situation involved an individual who named his three children from his first marriage as beneficiaries of his RRSPs, and left his second wife as beneficiary of the residue of his estate. His will contained a common clause directing his executrix to pay any taxes arising because of his death. Such a clause can produce unintended results, though.

In this case, the estate was responsible for paying the income tax associated with the RRSPs. As a result, the children received as their inheritance the full value of the RRSPs, while the second wife received the residual value of the estate, which had been reduced by the RRSP tax liability.

The Income Tax Act (the “Act”) deems RRSP values to be included in a deceased’s income immediately before death, although the funds may actually be paid to an RRSP beneficiary. The Act also specifically allows the CCRA to collect

the estate’s RRSP-related tax liability from the beneficiary of those funds. While there is joint and several liability for the income tax payable, the court held that the estate has the primary responsibility because the funds are deemed to be a payment to the deceased immediately before his or her death. Only if the estate has insufficient resources to pay the income taxes can the CCRA look to the beneficiaries of the RRSPs for payment.

This case serves as a reminder that estate plans must fit all the pieces together, from the will to the beneficiary designations, to achieve the desired outcome.

I/R 5401.06, 2121.00

PLANNED GIVING

Recent federal budgets have afforded more favourable tax treatment to the concept of planned charitable giving. Over the years, the following changes have been made:

- the deductible limit has been increased to 75 per cent of the donor's net income. This increases to 100 per cent for the year of death and the year preceding death;
- the capital gains inclusion rate has been temporarily cut in half for donations of appreciated shares of publicly traded companies; and
- a bequest can now be accomplished by naming a charity as beneficiary of a life insurance policy.

The structure of the bequest will affect the income tax consequences and the net cost of the gift to the donor. While there are many ways to structure a planned gift, this discussion is restricted to those plans and strategies that benefit the charity upon the death of the donor or, in other words, retain the target assets under the control of the donor until death.

Cash - A bequest could be funded using cash from within the estate. The income tax savings result from a non-refundable tax credit calculated as the amount of the gift times the top marginal tax rate. If there are sufficient income taxes payable within the estate as a whole, that tax credit can reduce the "cost" of the gift to a little more than 50 per cent of the actual amount donated.

Insurance - Purchasing a life insurance policy today and naming a charity as the beneficiary of the policy could fund a bequest. In this case, the testator retains control of the insurance policy during his

or her lifetime and does not receive a tax credit for any of the premiums. The charitable organization receives the planned gift as beneficiary of the insurance policy. A fairly new Income Tax Act provision allows the executor to claim the value of the life insurance proceeds as a charitable gift on the deceased's terminal income tax return. Similar to the cash bequest, a non-refundable income tax credit is created and, if sufficient income taxes are payable by the estate as a whole, the tax savings should be close to 50 per cent of the insurance proceeds. Keep in mind that the deductibility limitation is 100 per cent of the testator's net income in the year of death, but that any excess can be carried back to the immediately preceding year (subject to the same 100 per cent limitation).

Appreciated shares - A bequest could be funded by transferring title of a specific stock portfolio to a charity at the time of death. Similar to the previous examples, the deceased can claim a non-refundable tax credit and be eligible for income tax relief of close to 50 per cent of the fair market value of the stock at the time of death. However, there are some issues with this type of strategy. One concern is that the testator may have disposed of the particular stocks referred to in the will before the time of death (since, as time passes, the make-up of the portfolio is likely to change). Also remember that there is a deemed disposition of the shares — and thus a potential capital gain — immediately before death. However, where the death occurs before January 1, 2002, the capital gains inclusion rate is one-half of the regular rate (i.e., 25 per cent) for bequests of certain shares and securities to a charity.

RRSP - Rollover provisions in the Income Tax Act allow for the deferral of income taxes on registered retirement savings plan

(RRSP) assets transferred to a spouse or, in some cases, to a dependent child. Where appropriate, however, designating a charity as the beneficiary of an RRSP may be a viable option for completing a bequest. For example, this application may work well with the second-to-die of a married couple. The full value of the RRSPs will be taxed on the final income tax return, but the resulting liability will be negated by the non-refundable tax credit generated

by the gift. The tax credit may even exceed the tax on the RRSP proceeds because the credit is calculated using the top marginal tax rate, while the deceased may not be subject to tax at the top rate on part or all of the RRSP income inclusion (depending on other income).

I/R 1600.00

TESTAMENTARY TRUSTS – AS A PLANNING STRATEGY

Testamentary trusts are created upon the death of the person establishing the trusts (testator), and are effected most often through express directions in a will, and sometimes in other trust documents. Such a trust can be an effective tool for achieving specific outcomes.

Structure

The establishment of a testamentary trust creates a legal structure that allows the deceased to ensure that his or her final wishes and directives are carried out. There is great flexibility within trust planning, allowing the deceased to tailor bequests to suit the specific circumstances of each beneficiary.

In addition, the deceased can provide unlimited or specific decision-making authority to the trustee. For example, a trustee may be given discretion to dispose of assets as may be necessary given the specific circumstances of the beneficiaries. Alternatively, the trust can provide clear direction with specific authority for the trustee, leaving the trustee with little decision-making authority.

Harmony

Testamentary trusts are valuable for ensuring the needs of minor children as

beneficiaries are well cared for and that a qualified trustee is in place to oversee the management of the capital.

Often, an individual may have a valued asset, such as a family cottage or farm property, that he or she would like to see remain in the family for enjoyment by all family members. Using a testamentary trust, ownership of the asset can be transferred to and managed by the trustee. This allows the testator to establish specific guidelines as to how it will be shared and how the expenses will be managed. Alternatively, the testator can leave these issues to the trustee's discretion. This can reduce the likelihood of family disputes over the use and upkeep or sale of the property.

Tax planning

Certain types of trust income, including dividends and capital gains, retain their character when they are paid from the trust to the beneficiary. For example, if a beneficiary receives the proceeds from the disposition by the trust of a capital asset, any realized gain receives favourable capital gains taxation, which can flow through to the beneficiary. Also, these gains can be offset by any capital losses of the beneficiary.

Testamentary trusts are taxed on the same progressive tax rate schedules as individuals, which can be an attractive feature. Where there are beneficiaries with a high marginal tax rate, taxing income within the trust can provide substantial savings. By placing income-producing property in a trust, the settlor takes advantage of these income-splitting opportunities.

For example, capital left to a surviving spouse could be divided between a testamentary trust and the spouse directly. The testamentary trust could be designed to pay income, capital, or both to the surviving spouse in a discretionary manner to meet his or her needs. In this fashion, some income could be retained and taxed in the trust. Since the trust has progressive tax rates, the tax cost should be less than adding the entire income to the spouse's income tax return.

Income earned by a testamentary trust is reported to the trust. The trustee, with specific authority, can elect to have the income taxed to the trust even it is has been paid (or is payable) to the beneficiary. Alternatively, the income can be allocated

and taxed in the hands of the beneficiary. There is no attribution of income to the testator.

Establishing two or more separate trusts for two or more beneficiaries provides additional mechanisms for income splitting after death. The use of multiple trusts may add trust administration costs, but these may be offset by the tax savings. Separate trusts established for each of the children or grandchildren of the deceased could provide greater tax savings than establishing a single trust for all of the deceased's children or grandchildren (depending upon the size of the estate and the personal tax situation of each of the beneficiaries).

In conclusion

Testamentary trusts can be valuable conduits that allow the deceased to achieve a broad range of estate planning objectives.

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