Intermediate Estate Planning Techniques: Tax Issues

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Estate Planning Essentials

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I. Introduction

As the Canadian population ages, the complex matter of wealth transfer is becoming more and more important. Failure to address wealth transfer in a proactive manner may result in substantially greater and accelerated liability for Canadian income tax under the terms of the *Income Tax Act*.[1] This paper discusses some basic ways to mitigate and defer such income tax liability using various techniques, including by transferring future growth in value to subsequent generations (commonly referred to as an "estate freeze"). Points of emphasis include:

- What happens from an income tax perspective when a taxpayer dies;
- Why an individual may consider making certain types of gifts while they are alive;
- Several alternative structures for implementing estate freezes;
- Issues regarding the use of family trusts in estate freeze structures;
- Matrimonial considerations when undertaking an estate freeze; and
- The effects of including a non-resident in an estate freeze.

The purpose of this paper is not to provide a detailed analysis or in-depth review of all of the various income tax issues and nuances that may arise in the estate planning context and should not be considered a substitute for obtaining competent tax advice. Rather, the intent is to provide a general overview of

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[1] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), as amended (herein referred to as the "Tax Act"). Unless otherwise stated, statutory references in this paper are to the Tax Act.

some of the more common tax issues, some of the pitfalls, and some of the planning opportunities that may be available when assisting a client with their estate planning.

II. Taxation on Death

Generally, there is no estate tax or "death" tax imposed by the Tax Act when an individual dies. However, immediately prior to the death of an individual, he or she is deemed to have disposed of most kinds of capital properties, including eligible capital properties, land inventories and resource properties for fair market value proceeds of disposition. Examples of property subject to this deemed disposition includes shares in public and private corporations and real property (e.g. the primary residence, rental properties or the family cottage).

As a result of the deemed disposition under the Tax Act, all unrealized capital gains (and losses) are triggered and the net gain (or loss, if any) is included in the individual's income. For example, assume an individual purchased a rental property for $200,000 during their lifetime. If the individual continues to own the rental property until the date of her death, and if the property has a fair market value of $300,000 on that date, the individual will realize a capital gain in the amount of $100,000, being the amount by which the deemed fair market value proceeds of disposition (i.e. $300,000) exceeds the adjusted cost base of that property (i.e. $200,000), resulting in an income tax liability of approximately $24,000.[2]

It is important to note that the Tax Act does allow, in certain circumstances, for the deferral or reduction of the income taxes that would otherwise become

[2] All income tax examples/calculations are inserted for illustrative purposes. They are calculated based on the top combined Federal/Alberta provincial rates for 2016 and are subject to rounding.