Strategies to minimize your estate taxes

You pay taxes all your life. Unfortunately you'll even have to pay taxes when you die. But there are ways to minimize those taxes, so why not take advantage of them? After all, who would you rather your money go to – the government or your loved ones?

To find out more, click on one of the following topics:
-Keeping the government out
-Minimizing or eliminating probate taxes
-Planned Giving, a great way to reduce taxes

Keeping the Government out

One of the goals of any good estate plan is to minimize taxes. Because unless you take steps to avoid it, a great deal of your estate could go to the government. That's largely because of a rule known as "deemed disposition".

Under the deemed disposition rule of the income tax act, when you die, all your assets are treated as if they had been sold.

The government will treat your registered assets – your RRSPs and RRIFs – as if you had cashed them in and taken all the money, requiring tax to be paid. One way to avoid this is to plan to spend all your registered assets before you die.

Of course, this strategy does require careful planning. Firstly, you don't want to deplete this resource before you die. And second, you want to keep your withdrawals low enough so that you don't move to higher tax brackets or incur a clawback on your OAS.

As for your non-registered assets, with the exception of your home, they are treated as if they had been sold at market value at the time of your death, and you would have to pay tax on any capital gains.

In addition, your estate may have to pay provincial probate fees. The fees vary but are usually set as a percentage of the value of your estate.

Fortunately, there are ways to avoid or at least defer these taxes. A few are discussed in the sections: Minimizing or eliminating probate taxes, and Planned Giving, a great way to reduce taxes.

Minimizing or eliminating probate taxes

Probate is a legal process that confirms two things: the appointment of the executor* and the validity of the Will. After your death, your executor and your lawyer submit your Will and an inventory of your assets to the provincial court.

*In the province of Quebec, an ‘executor’ is called a ‘liquidator’, and in the province of Ontario, an ‘estate trustee’.

When the court accepts these documents, it issues what are called “letters probate”, that verify the Will is valid and confirm the appointment of the executor.

Before the letters probate is issued however, the executor must pay a probate tax. This tax is based on the total value of the assets in the estate. The rate varies between provinces and can be significant. In Ontario for instance, a $1,000,000 estate would pay $14,500 in what Ontario calls "estate administration tax."

The good news is that you can structure ownership of your assets in ways that either avoid or minimize probate taxes. Essentially the strategy is to create an ownership structure in which the asset does not become part of your estate when you die.

For example, if you hold assets such as your home or cottage in “joint tenancy with right of survivorship”, upon death, the asset is passed to the surviving individual. It therefore remains outside of the estate and there is no probate.

You can also avoid probate by naming a specific beneficiary to receive certain assets such as registered accounts. When you die, the asset passes directly to the beneficiary, remaining outside the estate and avoiding probate. Proceeds of a life insurance policy are treated the same way.

Another way to keep assets outside of the estate is to create a trust. Once the trust is created, ownership of the assets within it is transferred to the beneficiary and they are not considered part of the estate.

There are other strategies, but there can be legal and/or accounting fees involved. Just be sure that the costs of planning, implementing and administering any strategy does not outweigh the cost of probate.

Planned Giving, a great way to reduce taxes

Canadians have always been generous in donating their time and money to charitable organizations. But in recent years, they've had to be even more generous. Because governments have cut back on direct funding to charitable groups, the responsibility has fallen on corporations and individuals to fill the gap.
Fortunately, a number of tax incentives have been introduced by governments to encourage more private giving. With these legislative changes, the structure of charitable giving can be just as important as the amount that is given, both to the charity and to the client.

Charitable giving is a unique opportunity
There are not all that many opportunities in life to 'have your cake and eat it too'. Planned or charitable giving is one of them.

A planned or charitable gift is defined as a gift to a charitable organization made in such a way that you're able to maximize any tax and estate planning advantages.

Your gift can take many forms and be made in a variety of ways

Planned gifts can take many forms including cash, publicly traded stocks, bonds, stock options, mutual funds, cultural and art objects, real estate and life insurance proceeds.

In addition to gifts made prior to death, some of the ways in which gifts can be made are:

-Bequests under a will – There are many options for creating a bequest in your will, each with advantages and disadvantages. You should seek the advice of an expert to find out which might be best for you.

-Life insurance - You can put a life insurance policy in place that will pay a specified sum to the chosen charity by naming it the beneficiary of the proceeds. You can then claim the annual cost of the insurance policy as a charitable donation, even though the money is bequeathed only upon your death. Or you can name your estate as your beneficiary and include the charity in your will. In this way the tax advantage is for your estate.

-Gifts of RSP or RIF assets

-Charitable gift annuities – This allows you to give a lump sum to a charity and receive periodic income in return. This arrangement is most beneficial for those aged 70 or over.

-Charitable remainder trusts – This is essentially a living trust you establish by contributing your assets and which pays you an income while you're alive. Upon your death the remainder of the trust will pass directly to the charity you have named. The advantage is that you can enjoy tax advantages while alive, compared to a bequest which only benefits your estate.

Please note: This section on planned giving has been included in the Estate Planning section because so many charitable gifts are based on a transfer of assets upon death of the donor.

One reason for this is the fact that in the year of death and the previous year, 100% of the donation can be deducted from the net income of the estate.

However, you should be aware that planned giving while you're alive can also provide you with significant tax advantages, up to a maximum of 75% of net income per year.

In both cases, whether as part of your estate plan, or as part of your financial and tax planning, it is strongly recommended that you seek guidance from independent experts to ensure that all your financial goals and your wishes for the charitable organization are met. One person who can help you is a CPA Financial Planning professional, click here to find one near you.