

# Tips and Traps in Succession and Estate Planning

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# Agenda

- **Estate planning**
  - Alter-ego and joint partner trusts... the technical issues
  - Tax on death... what advisors miss
  - Recent valuation concerns
  - Non-resident beneficiaries
- **Succession planning**
  - Ignoring the corporation today... purification problems
  - Not preparing the next generation
  - Unintended association and family trusts

# Tips and traps in succession and estate planning

## Overview

- Early attention to estate and succession planning is a key component of wealth management
  - Lack of attention can result in inflexibility and higher overall tax
  - However, some components of the planning can create unintended issues and complications later
- The advisor needs to understand both of these issues when dealing with clients

# Tips and traps in succession and estate planning

## Alter-ego and joint partner trusts

- What is an alter-ego/joint partner trust?
- Why are these used?
  - Privacy
  - Protecting the intent of the deceased
  - Probate fees



# Tips and traps in succession and estate planning

## Alter-ego and joint partner trusts

- Issues related to double tax – carrying back losses
  - Typical loss carry back rules do not apply (ITA 164(6))
  - Need to rely on the general loss carry back rules
  - Affiliation is now a concern
- Issues related to double tax - Roll and bump strategies
  - Is a roll and bump/pipeline strategy available?

# Tips and traps in succession and estate planning

## Alter-ego and joint partner trusts

- Donations post mortem
  - Cash donations or donations of securities
- Capital gains exemption availability

# Tips and traps in succession and estate planning

## Alter-ego and joint partner trusts

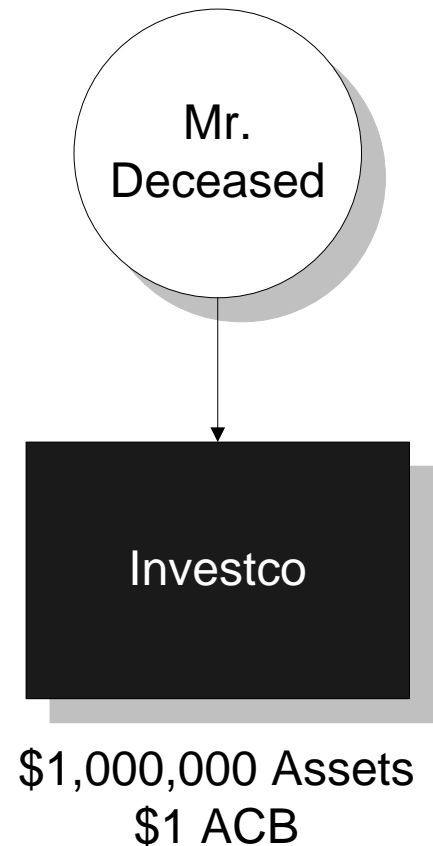
- Ability to use a testamentary trust
  - Testamentary trusts receive their own marginal tax rates
  - This can save a beneficiary up to \$15,000 in tax annually
  - A testamentary trust cannot be funded from assets held in an alter-ego or joint partner trust
  - Need to consider leaving a portion of the assets in the estate to fund a testamentary trust



# Tips and traps in succession and estate planning

## Tax on death

- Avoiding double tax on death
  - What is it?
    - Two layers of tax... tax on the shares of a company and tax on the underlying assets
  - How to avoid the double tax issue
    - Redeem shares and carry back losses to the final return to reduce the deemed disposition on death
    - Roll and bump/pipeline



# Tips and traps in succession and estate planning

## Tax on death

- Redemption of shares
  - If in the estate within first taxation year following death
  - Otherwise, within the normal loss carry back period
    - Trust must continue to exist after death
  - Redemptions by spousal, alter-ego and JP trusts must ensure the loss is not denied due to affiliation
- Brief mechanics...

# Tips and traps in succession and estate planning

## Tax on death

- Redemption of shares without RD'TOH or CDA
  - taxed at dividend rate vs. cap gain
- Need to ensure there is sufficient RD'TOH and/or CDA
  - Sell and re-acquire underlying assets
- If not, roll and bump is preferred
  - Careful of the ineligible property rules if a roll and bump is used

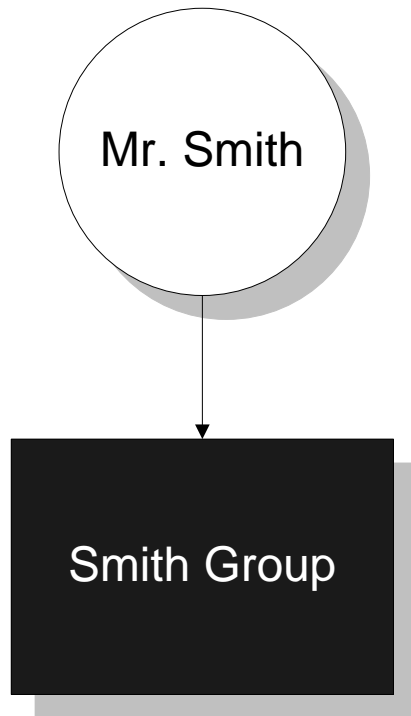
# Tips and traps in succession and estate planning

## Operating company purification and structure

- Proper structuring of business assets is often overlooked until too late
- Concerns...
  - Cash, investments, CSV of insurance contracts in the wrong company
  - Co-mingling distinct businesses
  - Real estate (active or otherwise) in the business
  - Lack of income splitting ability

# Tips and traps in succession and estate planning

## Operating company purification and structure



### Current Situation

- Spouse has little involvement in the business but no other sources of income
- Profit is in excess of needs of business and shareholder
- Cash is being accumulated
- Smith Group owns an insurance contract with \$400,000 of CSV
- Company owns real property
- Used in the business
- Portion lease to 3rd party
- Company has 2 distinct business operations

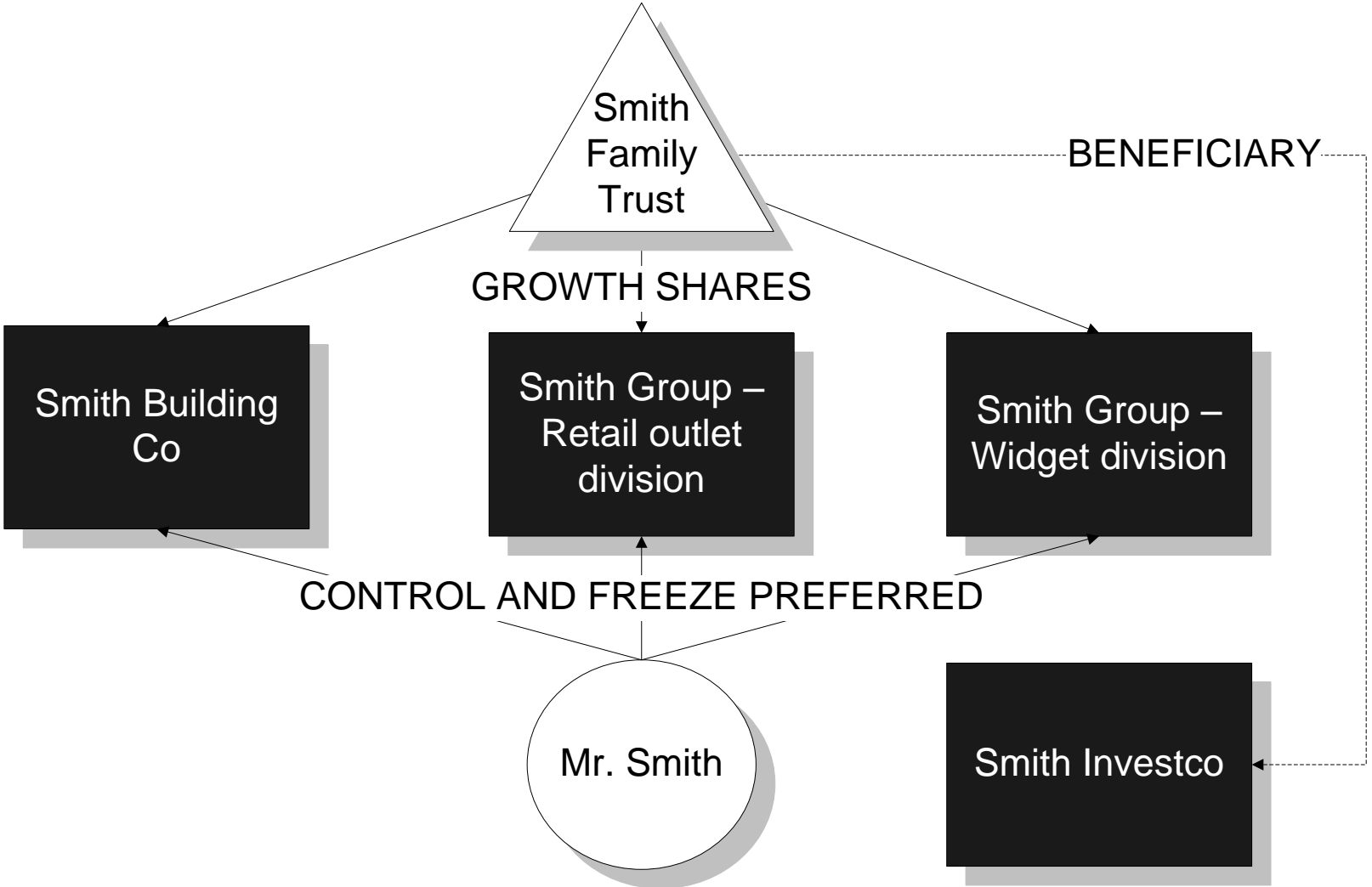
# Tips and traps in succession and estate planning

## Operating company purification and structure

- Inflexible
- Inability to income split
- Tax efficient removal of business profit is difficult
- Assets no longer needed in the business are exposed to creditors and may cause issues with the enhanced capital gains exemption
- Insurance contract is a passive asset that could jeopardize the ECGE and will not be wanted by a future owner
- Building may make the company too expensive for potential purchasers.
- A portion of the building may be a passive asset
- Cannot sell one of the two businesses if shares are sold
- Tax on death

# Tips and traps in succession and estate planning

## Operating company purification and structure



# Tips and traps in succession and estate planning

## Operating company purification and structure

- Separate companies...
  - Real estate and the two operating businesses are in separate legal entities
  - Facilitates a partial sale later
  - Reduces value of operating businesses (without real property) to facilitate selling
  - Separates business risks
  - Real estate... active business??
  - Small business deduction??



# Tips and traps in succession and estate planning

## Operating company purification and structure

- Passive assets...
  - Passive assets are moved to Investco
  - Mechanism is in place to permit the continual purification of operating businesses
    - Can use a trust or other methods
    - Careful planning needed to ensure corporate attribution and trust problems are anticipated
  - Assists in operating businesses meeting the active asset tests for the capital gains exemption

# Tips and traps in succession and estate planning

## Other issues

- US citizens/green card holders
  - Required to file US returns and report worldwide income whether they are resident in the US or not
- Canadians moving to the US on a permanent basis
  - Children of our business owner/high net worth clients
  - Impact on previous Canadian planning
- Implications to planning
  - Difficulty with freezes, restructuring, etc
  - Look through rules on family trusts
  - Get advice from a Cross border tax specialist

# Tips and traps in succession and estate planning

## Other issues

- Discretionary family trusts
  - Becoming extremely common
  - Provide significant flexibility
  - Create unintended problems!!
    - Association over a vast range of companies on an unintended basis
- Voting control preferred shares
  - Why are they used?
  - CRA is suggesting these may have value!?!?!
    - Risk, what to do, what to tell clients

# Tips and traps in succession and estate planning

Questions?

Thank You