

ADVANCED WILL PLANNING

A. Introduction

There are as many alternatives for estate planning strategies as there are individuals who wish to plan for their estate succession. What most clients require is fairly straightforward. They need to establish a means of passing their assets easily to the next generation. Some clients have the need for a more complex approach to will planning. Usually those clients with an asset base that is larger than average have the opportunity to create more intricate and beneficial plans for their heirs. These strategies can include the creation of insurance trusts, making multiple wills, establishing a number of testamentary trusts, and providing trustees with the flexibility they need to effectively administer assets. This paper will introduce and describe the circumstances when these strategies may be required and the benefit they provide.

B. Insurance Trusts

Proceeds payable under an insurance policy can be the subject of an insurance trust created by will or a separate document outside of a will. Such a trust will require trustees to hold, invest and distribute the proceeds from the insurance policy in accordance with specific terms of trust. The proceeds are payable to the individual trustee(s), not the estate, and are therefore outside of the estate, and not subject to probate charges.

In order to qualify as an insurance trust:

- the settlor must be the owner of the insurance policy
- the payment of the proceeds of insurance has to be a result of the settlor's death, i.e. it must be the settlor's life that is insured

- the settlor must designate by proper designation the trustee(s) of the trust as the beneficiary(ies)
- no property, even nominal in value, can be transferred into the trust prior to the settlor's death
- the insurance designation must qualify as a testamentary instrument, meaning it needs to be revocable.

There are a number of advantages to creating one or several insurance trusts in a will. These advantages are set out below.

1. *Avoiding probate fees* – Insurance payments that are not routed into the estate on the death of the individual do not comprise part of the assets of the estate for purposes of the probate fee calculation. An insurance trust does not attract these court fees on the death of the individual. On a \$1,000,000 policy, a saving of \$6,000.00 in probate fees will be generated in Manitoba. In Ontario the saving is \$15,000.00.
2. *Confidentiality* – Since the insurance proceeds do not pass through the estate, the insurance proceeds do not have to be disclosed when applying for probate and, thus, the amount of proceeds and their destination do not become a matter of public record. Further, the terms of the insurance trusts themselves can be set out in a separate document (separate from the will), so that the terms do not become a matter of public record. The terms of the trust must be disclosed to CCRA but not to any next of kin not directly involved in the administration of the trust.

Some people have complicated personal relationships that may result in certain moral obligations to different families. An example of this is where a past relationship (or an extramarital relationship) has resulted in a moral obligation to provide for a child on the death of the individual. It may be difficult to allocate family owned assets to fulfill this obligation, yet if not

done it may result in nasty litigation after the individual dies. An insurance trust can be tailored to resolve this difficult situation. An insurance trust can be set up as a fully secret trust. The family of the deceased does not have to go through the emotional turmoil that could result if the dependent child of the deceased sues the estate for support.

In addition, some people may want to favour one family member. For example, they might have several children and want to make a special or extra allowance for one of them without the others' knowledge.

3. *Creditor Proofing* – The law from Province to Province in Canada expressly makes insurance proceeds free from the claims by creditors of the deceased. This is the case as long as the proceeds pass outside of the estate. There may be claims that arise against estate assets that virtually wipe out any hopes of security for the survivors. Setting up one or a number of insurance trusts for dependent beneficiaries may be the alternative for these clients.

4. *Taxed as a Testamentary Trusts* - An insurance trust can be established as a testamentary trust and a testamentary trust can be an effective tax planning tool (as discussed in the section below). Estate planners want to be aware of the tax benefits to establishing a testamentary trust so that their clients can take advantage of these benefits if the conditions are right. Usually a testamentary trust is created by an individual's last will and testament with the assets that comprise that individual's estate.

C. Multiple Testamentary Trusts

Some situations allow for the creation of multiple testamentary trusts. Trusts established under a Last Will and Testament and funded with assets flowing through the estate of the deceased clearly qualify as testamentary trusts. Assets can also be transferred from one testamentary trust in some circumstances and flowed into another testamentary trust without losing the qualifying status. A testamentary trust is frequently set up for a surviving spouse on the express terms that when the surviving spouse passes away the remaining contents of the spousal trust will then be divided into a series of testamentary trusts for the children. CCRA has said in a technical interpretation that the trust would continue to qualify as a testamentary trust under those circumstances.

A trust is not a separate legal entity at law, but it is treated as a separate taxpayer under the *Act*. This allows for considerable tax avoidance as discussed below.

1. *Application of Graduated Rates* - A testamentary trust pays tax on a graduated basis. The first \$32,183.00 of income is enjoyed at the lowest rate. The next \$32,185.00 is in the second, higher, tax bracket, the next \$40,262.00 of income on top of that is taxed in the third tax bracket, and income on top of that is taxed in the fourth tax bracket. Although a testamentary trust receives graduated tax treatment just like a flesh and blood person, it does not receive the personal income exemption.
2. *Multiple Trusts* - Since each trust is a separate taxpayer, there will be circumstances in which one seeks to establish as many trusts as possible to try to expand the tax base. A separate trust for each beneficiary achieves that result. Each trust will file its own tax return. Each will enjoy its first \$32,183.00 of income at the lowest rates.

If, however, you try to establish multiple trusts for the same beneficiary, you may discover that Canada Customs and Revenue taxes them all as one collectivity under subsection 104(2) of the Act. Some of the circumstances that will determine the application of subsection 104(2) as follows:

- Whether or not there was a clear intent by the testator, as evidenced by the terms of the will, to create separate trusts;
- Whether or not the trusts had common beneficiaries;
- Whether or not the assets of each trust were segregated and accounted for separately (e.g. separate bank accounts, no undivided interests in property, separate accounting records), and
- The conduct and powers of the trustees.

With careful drafting and awareness of the issue, the application of ss. 104(2) can be avoided to provide additional tax savings generated by the creation of multiple trusts.

Example of How It Works

Consider the following example: Ted has inherited \$400,000 in the form of a trust for his benefit. It allows for the discretionary allocation of income among Ted, any wife he may have, and his two dependent children. As in the earlier example, it is invested at a 7% rate of return. Thus, \$28,000 in income is generated on the inherited pool of investments. Ted spends \$7,000 of trust income on each child, buying their books, bicycles and groceries, and taking them on family vacations. The balance of the income is taxed in the trust. Thus, \$14,000 of income is included on the children's returns and escapes taxation under their personal exemptions. The balance is taxed in the trust at a 26% rate. The total tax sent to CCRA is approximately \$3,640.00. If Ted had inherited outright the total

tax payable is \$12,880.00. The savings amount to approximately \$9,240 each year!

The above analysis oversimplifies – giving the children income impairs the ability to claim the children as dependents. If a full analysis is conducted, taking all factors into account, the savings stand up with very little erosion in most cases.

D. Multiple Wills

Another complex estate planning strategy available to testators is the use of multiple wills. Extreme care need be taken in drafting of multiple wills to ensure that the terms of each will do not conflict and that neither has the effect of revoking the other.

Use of multiple wills is not a tried and true strategy in Manitoba. Its success would be reliant on the case of *Granovsky Estate v. Ontario*, a 1998 decision from the General Division of the Supreme Court of Ontario.

In *Granovsky*, a testator had a Primary Will and a Secondary Will, drafted with the intention that only the Primary Will would be probated. The Secondary Will concerned the distribution of specific property that was expected to be capable of being transferred to designated individuals without the necessity of a probated will.

The value of the property detailed under the Secondary Will was significant. Its exclusion from the application for probate meant a saving of \$375,000.00 in probate charges.

The court in *Granovsky* considered a provision of Ontario's applicable legislation that allows for an application for a limited grant of probate supported by a

statement of value only of the property that is the subject of such a limited application. Subsection 24(3) of the Manitoba Court of Queen's Bench Surrogate Practice Act is similarly worded.

The provision was found to support the use of multiple wills, confirming the ability to apply for limited probate and payment of probate charges that only relate to the assets which are the subject of that application for probate.

The same strategy should work in Manitoba. Thus, a testator should be able to use a supplementary will that details a testator's intentions to distribute specific assets to specific beneficiaries without the need to include those assets in an application for probate. Two types of assets that this strategy may apply to are shares in a privately held corporation and cottage property and associated personal property owned and located on Crown leased vacation land.

E. Jurisdiction Shopping

Some jurisdictions in Canada provide more favourable income tax treatment than others. This applies to income generated from a trust as well as income from other sources. When creating a long standing trust, consideration should be had to this issue. The powers of the trustee can include the ability to move the trust to the more favourable jurisdiction.

F. Information in this Paper not Substitute for Legal Advice

This paper is intended as an introduction to this topic. It is not a substitute for specific legal advice tailored to a client's particular needs. Any person wishing advice on how to order their affairs, or those of a client, should contact a member of our Wealth and Succession Practice Group. This paper is also based on the laws of Manitoba, and while laws are similar from Province to Province, the content of this paper may not be accurate in other provinces.

G. Conclusion

These are but a few examples of what certain sophisticated clients have chosen to do with their estate plans to increase the advantages passed on to their heirs. There are as many different kinds of will plans as there are individuals. Only when accountants, lawyers and financial advisors provide their clients with these possibilities do they provide a full estate planning service to their clients.

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