The ScotiaMcLeod Wealth Planning Series

Estate Planning Handbook

ScotiaMcLeod

Building Relationships for Life

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ScotiaMcLeod's Wealth Planning Services

Building and preserving wealth demands specialized financial advice. ScotiaMcLeod has established a full range of advisory services encompassing tax, estate and retirement planning. Our Wealth Planning Series of educational booklets has been developed to assist investors in all their individual financial planning needs. Ask your Investment Executive about other Wealth Planning publications.

The ScotiaMcLeod
Estate Planning Handbook

As with any type of planning, estate planning is a very individual process. However, the process can be broken down into steps that everyone should follow when developing an estate plan. This booklet has been developed to provide you with some information on estate planning and some of the issues that you should deal with. Certain items and terminology covered in this publication vary from province to province, so it is intended as a guide only. Please be sure to consult with your professional accountant, lawyer and Investment Executive when developing your estate plan.

What is Estate Planning?

Simply put, estate planning is the act of ensuring that your assets are distributed in the manner in which you desire. There are two essential components that an estate plan must consider and deal with if it is to be effective — the financial component and the administrative component.

Why is Estate Planning Important?

Without a proper estate plan, it may be possible that your wishes will not be carried out in the manner that you would like. Generally speaking, most people want to pass on as much as they can to their beneficiaries which means that they must have both components of the plan noted above. Not considering all aspects of an estate plan could result in unnecessary costs and unintended results.

The Components of Estate Planning

The estate planning process can be broken down into two major components: The **financial component** deals with the assets that you have and whether they will be sufficient to provide for your beneficiaries once they are distributed.

The **administrative component** deals with the implementation of the distribution of the assets to your beneficiaries. It is this part of the estate planning process that deals with Wills, Powers of Attorney, trusts and other structures as the means to distribute and manage your assets in the manner that you desire.

It is obvious that both components are very important — you should not assume that simply because you have a Will or have some life insurance, that you have an estate plan. While both a Will and life insurance are important for most people, they do not constitute a complete estate plan. Within both the financial and administrative components, there are goals and objectives that you will want to achieve. For example, how much money do you want to leave to a particular beneficiary and when would you like them to receive it?

The Estate Planning Process

The Financial Component

Asset Inventory

The first step in the estate planning process is to deal with the financial side. The starting point here is to list all of your assets and liabilities (See Appendix I). This is essentially your current assets plus life insurance coverage and current liabilities including any tax liabilities that may be due at death (remembering that unless you are leaving all of your assets to your spouse, tax consequences will result upon your death — see the section on Taxes at Death on page 9) and any funeral and other expenses that may be incurred on death. Once you have completed your asset and liability listing, you have a complete picture of what your resources are and what you are dealing with from an asset distribution perspective.

Goals and Objectives

The next step is to determine your estate planning goals and objectives. This usually means deciding who your beneficiaries will be. At this stage, you should also consider any income requirements your beneficiaries may have and/or how much of your estate you would like to leave them. During this process, you must compare your estate resources to your goals and objectives to determine whether your resources will achieve your goals. This is often a very subjective assessment as it deals with lifestyle issues and the cost of your goals and objectives. Remember to consider the impact of inflation on your estate distribution.

Generally speaking, this part of the financial process ends with a conclusion of whether or not your goals and objectives can be achieved with your current financial resources. If your current resources fall short, you will need to consider whether the costs of implementing your plan are appropriate or if your goals and objectives need to be modified.

The Effects of Inflation

With any type of planning, inflation is a big factor to consider. Estate planning is no different. When you are planning for beneficiaries, be sure to consider the effect that inflation will have over time. Although inflation has remained relatively low over the last few years compared to historical levels, there is no guarantee that this period of low inflation will continue. The chart below shows the amount of money that would be needed over a ten and twenty year period at various inflation levels to maintain purchasing power of $40,000.

Inflation	10 years	20 years
2.0%	48,760	59,438
3.0%	53,757	72,244
4.0%	59,209	87,645
5.0%	65,155	106,132

There are a number of factors to consider when evaluating your estate goals. Immediate factors usually deal with the support of your family. In this case, the age of beneficiaries and the length of time that financial support may be required are fundamental factors to be considered. In addition to these factors there are other issues that will arise. The following questions are not meant to be exhaustive but to give you an idea of other factors to consider.

- Are there any special needs that beneficiaries have?
- How important is tax planning in your estate plan?
- Do you care when your beneficiaries receive their inheritance?
- How long do you want to provide support to your family?
- Do you want to leave any money to a charitable organization?
- Is there a family business or other asset that requires special attention?

The Role of Life Insurance in the Estate Planning Process

For many people, life insurance is a very important component of their estate plan. The primary role of life insurance is to accomplish either estate creation or estate preservation objectives. For younger individuals, the estate creation objective is often of most importance while for older individuals that have accumulated other assets, hanging onto those assets, or preserving their estate is usually the reason that they have life insurance.

One of the major advantages of life insurance is the tax treatment. While premiums are usually not deductible, benefits paid to beneficiaries are not taxable. This presents many planning opportunities.

Types of Life Insurance

There are two main types of life insurance:

- Temporary Insurance is used for a specified period of time to provide for specific issues, such as to pay off a mortgage
- Permanent Insurance remains with the insured for their lifetime

Temporary Insurance

Term Insurance

The most common type of temporary insurance is term insurance. As noted above, this type of insurance is for a specified period of time, usually to cover a specific objective. Coverage is typically offered in five and ten year terms with renewable and convertible options. Term insurance is usually the most inexpensive type of coverage as it is for a limited period of time and there is no investment component to the coverage. The coverage remains in effect for as long as premiums are paid and the term hasn't expired. Generally speaking, as terms are renewed, the cost of insurance goes up.

Permanent Insurance

Level Term (Term to 100)

Although the word "term" is included in the description of this type of insurance, it is a permanent type of insurance. Term to 100 will cover you for your lifetime, as long as you continue to pay the premiums. Premiums are usually level throughout your life and are usually higher than straight term insurance.

Whole Life

Whole life coverage also provides protection for your lifetime but it contains a savings component as well. These types of policies are funded with premiums that are split to cover the risk premium (the insurance component) with the remainder of the premium being invested inside the policy. Over time, the excess premium over the risk premium builds to what is referred to as a cash value.

Universal Life

Universal Life is a form of permanent insurance that offers more flexibility with respect to premiums and coverage amounts. It also consists of two parts - an insurance component and an investment account. Interest earned in the investment account compounds on a tax deferred basis, subject to certain limitations. The result is a tax efficient policy with maximized policy values.

What Type is Appropriate?

The type of insurance that is most appropriate depends upon your estate goals and objectives, but most people require both types of insurance during their lifetime. Permanent insurance provides ongoing protection for beneficiaries and against possible non-insurability in the future. Temporary insurance is often used to supplement permanent coverage for particular issues that arise during an individual's life. Generally speaking, the older you get, the less life insurance you need because you begin to build up other assets that can provide for beneficiaries. However, this is not always the case. Many people, as they age, find that they continue to require coverage to guard against tax liabilities at their death, thereby protecting the value of their estate.

How Much Insurance Should I Have?

The amount of insurance you require will depend upon your personal circumstances, assets and estate goals and objectives. Generally speaking, as noted above, the older you are, the less you are likely to require straight life insurance. However, there are products that will help with more than one aspect of estate and retirement planning. Each case should be evaluated in the context of your overall financial plan.

The ScotiaMcLeod Financial Services publication entitled *Estate Planning Through Insurance: Protecting Your Wealth* presents some advanced estate planning strategies and options to increase and preserve the value of your estate.

The Administrative Component

Once the financial side of estate planning has been dealt with and you have determined that your resources will be sufficient to achieve your goals and objectives, the next step is to determine how and when you would like to distribute your assets. This section will look at the alternatives for distributing your estate and provide some information on the vehicles that will be required to make sure your estate gets distributed in the manner that you wish.

Distributing Your Estate

Estate distributions can take place at various times including prior to death, at the point of death or after death. The following are the four methods of distributing your estate to your beneficiaries:

- A Will
- Joint Ownership of Assets
- Gift of Assets
- The Use of Trusts

Wills

The Will is the document that most individuals are familiar with as a method of distributing your estate. While it is essential for everyone to have a Will, the other methods of distributing your estate should also be considered. However, your Will represents the primary mechanism to distribute your estate.

Why Have a Will?

The Will serves two purposes. The first is to designate a person (called an executor or liquidator in Quebec) who will be responsible for making sure that the distribution of your assets is administered according to the wishes outlined in your Will. The second reason for a Will is to establish how and when you would like your assets distributed to your beneficiaries.

Your Will typically includes clauses:

- to outline the powers of the executors;
- to invoke any limitations on the distribution and management of the assets;
- to appoint guardians for your children (if appropriate);
- to outline your burial requests;
- to deal with the distribution of personal effects;
- to deal with the distribution of your estate in the event that your primary and secondary beneficiaries have predeceased you

Beneficiaries

Beneficiaries are typically broken down into two types — primary and secondary. For most individuals, primary beneficiaries are immediate family members (usually spouses and children). Secondary beneficiaries are anyone else that you wish to distribute assets to. Once your beneficiaries have been determined, you then have to decide what assets you want to distribute and how and when you want them to receive these assets.

Types of Wills

There are effectively two types of Wills, with a third type available in the province of Quebec.

The first type and most simple form of Will is a **Holograph Will** prepared entirely in your handwriting and signed by you. There are no other formal requirements in order for this type of Will to be valid and effective.

Holograph Wills are recognized as being valid for all purposes in Alberta, Manitoba, New Brunswick, Newfoundland, Ontario, Quebec and Saskatchewan. In other provinces such as British Columbia and Nova Scotia, Holograph Wills are recognized to be valid only insofar as the Will relates to property other than real estate, assuming certain conditions are met.

More common is a **Formal Will** which is usually prepared by a lawyer. This type of Will is signed by you and witnessed by two individuals present at the same time. (These individuals must be at the age of majority and cannot be your spouse, beneficiaries, or dependents. Additionally, these individuals cannot be the potential beneficiaries of any such persons.)

In Quebec, there is a third type of Will available, known as a **Notarial** Will which is made before a notary in the presence of one witness (in certain cases, two witnesses may be required), and remains in the notary's office.

Reviewing Your Will

Your Will should be reviewed whenever there is a major change in your life or every two to three years, as the consequences of having a Will which is out of date may be worse than if a Will had not been prepared at all. Major changes in your life would include:

- Marriage
- Birth of a child
- Divorce
- Changes in your financial situation
- Move to another province or country

Furthermore, other factors which may make it important to review your Will are the death of a beneficiary or the executor or any changes in succession legislation or tax law which may impact the desired objectives set forth in the Will.

Reviewing your Will is essential to ensure that it continues to reflect your wishes. For more information on Wills, ask your Investment Executive for another publication in the Wealth Planning Series, *Drafting Your Will.*

Joint Ownership of Assets

Joint ownership of assets is very popular, especially among spouses as a way to hold and distribute assets. Joint ownership can provide some benefits from an estate perspective when the joint owner is someone that you would like the asset to pass to. However, there are a number of factors to consider when holding assets in joint title.

Joint Tenants with Right of Survivorship

This type of joint account means that two or more people own the asset. An individual listed as a joint tenant has ownership and control of the asset. Upon death of one of the tenants, the remaining tenants automatically receive ownership of the deceased tenant's portion. As this asset passes directly, it does not form part of the deceased tenant's estate and therefore is not subject to probate fees.

There are a number of factors to consider with this type of account:

- Each tenant has equal right of ownership and control (this may be a concern if there are any creditors of one joint tenant because they would also have a right to the interest of that joint tenant in the asset).
- When one person owns the asset and registers it with joint tenants, there is a deemed disposition of the asset with the appropriate tax consequences (except when the joint tenant is a spouse and the assets transfer at the adjusted cost base).
- The other tenants should be beneficiaries of your estate since by being a joint tenant they have legal right to the assets.
- This type of ownership is not available in Quebec

Tenancy in Common

With tenancy in common arrangements, each tenant may or may not own equal parts of the asset. When a tenant in common passes away, their share is left to their beneficiaries and not to the other tenants in common. Note that assets with this type of ownership are usually subject to probate fees. Tenancy in Common is usually not appropriate when an estate planning objective is the sole reason for choosing this type of ownership.

Gift of Assets

Gifting assets is one of the easiest (and often the most efficient) ways of transferring assets. In many cases, parents will gift assets to children to help them with home purchases, education expenses, etc. However, gifting can also be very tax effective in that future tax consequences will accrue to the receiver (assuming they are not minor children or your spouse). Remember however, that assets gifted are deemed to be disposed of and there may be tax consequences. Also remember that once assets are gifted, control of those asset changes to the receiver of the gift.

Before gifting assets, it is very important to ensure that your financial position allows you to gift the assets without enduring any undue hardships during your lifetime. As noted above, you do lose control and ownership of the assets and while you may believe today that the individual(s) you gift the assets to may help you out in the future if the need arises, that may not be the case.

The Use of Trusts

There are two types of trusts that are used to accomplish estate planning objectives:

Inter-vivos (living) trust is a separate legal entity that is set up while you are alive to accomplish various types of financial planning goals.

Testamentary trust arises out of your Will and does not come into effect until your death. These types of trusts are usually used to effect asset distributions that you want to occur sometime after your death.

The primary purpose of a trust is to allow you to transfer ownership of assets to your beneficiaries while retaining control over the assets. There are numerous situations where trusts are appropriate. Some of the most popular uses are trusts for minors, charitable trusts and trusts for income splitting purposes with other family members. Trusts can be a complicated area and should not be set up without appropriate professional advice.

Powers of Attorney

Another important component of estate planning is the Power of Attorney. The Will is the document that will distribute your assets in the event of your death. However, if you become mentally or physically incapacitated before death, your Will does not apply and you will require a Power of Attorney to ensure someone can act on your behalf in dealing with your affairs.

The most common type of Power of Attorney deals with financial decisions regarding your personal property. A Power of Attorney can contain very broad or very limited authority under which your "attorney" can act. A limited Power of Attorney would allow the "attorney" to deal only with specified assets or decisions whereas a general power of attorney allows broad control of your financial affairs. You may grant a Power of Attorney for a limited amount of time such as for the duration of a vacation or indefinitely. However, it is important to note that the Power of Attorney ceases at your death.

Mental Incapacity

A Power of Attorney will not be enforceable if you become mentally incapacitated unless you specifically indicate that this is your wish and your attorney's authority should be maintained under these circumstances. To ensure that the powers would continue in subsequent mental incapacity, you should ensure that you have wording to this effect.

Living Wills

A Power of Attorney extends only to financial or property matters. Another component of dealing with situations that arise prior to your death is a "Living Will." Manitoba, B.C., Ontario, Quebec and Nova Scotia all have legislation that allows for Living Wills.

The purpose of a Living Will is to deal with instruction for your medical care in the event that you are incapacitated and unable to make those decisions. Instructions usually relate to the type of treatment that you may or may not want to receive.

Taxes at Death

While there are no estate taxes in Canada per se, tax planning should play an important role in your estate plan due to the deemed disposition rules, US estate taxes, and to a lesser extent, provincial probate fees that are payable at death. Each subject will be dealt with below.

Deemed Disposition

In the year of your death, a final tax return (or terminal return) is filed by your executor that includes all of your income for the year until the date of your death. Also, at your death, you are deemed to have disposed of all of your capital property and any unrealized capital gains are realized. The assets are treated as if they were sold immediately prior to your death and the resulting capital gains (or losses) are included in your final tax return. Note also that any registered assets (RRSPs, RRIFs, etc.) are deemed disposed of and their fair market value would also be included in your final tax return.

Taxes can be deferred by transferring your assets to your surviving spouse. In this case, the capital gains tax would not be due until the death of your spouse. Your spouse would "acquire" your assets at your original cost and no tax would be payable until they sold the asset or passed away. Registered assets work the same way in that if they are transferred to your spouse, there would be no taxes paid on the rollover, only when funds are removed and at the death of your spouse (if there were assets remaining). Note that in the case of your registered assets, there are some special provisions to provide for dependent children or grandchildren that will also lessen the tax burden on these assets while providing support for a child or a grandchild.

US Estate Tax

Even though you are not subject to US income tax, your estate may be subject to US estate tax if you die owning property situated in the US. This property includes real estate as well as securities such as stocks and certain types of corporate and government bonds.

The tax rates charged on the taxable portion of your estate range between 18% and 55% of the fair market value of the US assets less a credit that is available to Canadians described below. One thing that is of particular importance to note is that the tax is levied on fair market value and not appreciation of those assets.

There have been changes to the Canada-US tax treaty in recent years to reduce the number of Canadians that are subject to US estate tax.

Exempt Estates

If your total estate is less than $1.2 million and contains no real property (essentially real estate) then there would be no US estate taxes due. If your estate contains real property, taxes would be due on that portion of your estate.

Revised Credit

Currently, the credit that can be claimed by Canadians against US taxes payable is a ratio of your US assets divided by your worldwide assets and multiplied by $192,800. This credit can shelter up to $600,000 of assets however, due to the ratio, many Canadians cannot shelter the full $600,000.

Spousal Credit

In addition to the above credit, there is a non-refundable credit against US estate tax otherwise due for any property that is left to a spouse. This credit is limited to the tax attributable to the assets left to the spouse and the general credit noted above.

Credit for US Taxes Paid

Another revision allows for a credit equal to that amount of US estate taxes paid against any Canadian taxes that would otherwise be payable on the US assets in question. Prior to the change in the protocol, US estate taxes were not creditable against Canadian taxes and double tax occurred.

Possible Solutions

For many individuals, US estate tax can be a concern. Listed below are a few strategies that can be used to try and mitigate the effects of US estate tax. This type of planning is a complicated area and should be discussed with a tax advisor prior to implementation.

- Sell your assets prior to death (this is sometimes easier said than done).
- Purchase life insurance to cover the tax liability.
- Use a Canadian holding company — assets are held by a company and not an individual. This strategy should only be considered for people with significant US assets.
- Gift assets to reduce your estate value below US $1.2 million.
- Use Canadian mutual funds that invest in US securities for the US component of your portfolio.
- Establish a Joint tenancy account assuming that the joint tenant(s) can prove that they acquired the assets with their own funds.

Probate Fees

When you pass away, your executor will have to file to obtain Letters Probate from a provincial court. Probate involves submitting a Will and an inventory of the deceased's assets. Once the court has accepted the documents, Letters Probate are issued which effectively state the validity of the Will and also confirm the appointment of the executor.

A fee is also required when your executor files the appropriate documents. Fees vary by province and are usually based on the value of the assets in the inventory that is submitted. All provinces with the exception of Alberta and Quebec (who have flat fees) have graduated fees that can be significant (up to 1.5% of assets). Note that a Notarial Will in Quebec does not require probate.

You should check with your financial institution to determine what their specific probate policy is in the event that your situation may not require probate. Also, when trying to avoid probate, remember that there is usually a cost to set up a structure to accomplish avoidance — make sure the cost is reasonable in light of potential probate costs.

Professionals Involved in Your Estate Planning

There are very few professionals that can provide you with all the products and services that will be required to complete your estate plan. Accountants, lawyers and your Investment Executive all play a role in ensuring your estate plan is implemented according to your wishes. Given that, it is important that each professional be aware of the role of the other professionals who are helping you to co-ordinate your plan.

Many people start with the financial side to determine what their resources are and whether they are sufficient to achieve their goals and objectives. This will often lead the way to completing the estate planning process.

Getting Started...

This publication provides some general information and tools that can be used in the estate planning process. It is by no means all encompassing and should not be substituted for appropriate professional advice.

The first step for most people in starting the estate planning process is to take an inventory of assets and liabilities. You can use the appendix at the back of this publication to help you.

After you have gathered all the data on your financial affairs, the next step is to determine your goals and objectives. Remember that you can usually accomplish anything that you want - it is only a matter of whether it is cost efficient and reasonable given personal circumstances. The professionals that you deal with can help you determine what is ultimately appropriate for you, given your goals and objectives.

Appendix I

Balance Sheet and Statement of Net Worth as of ______________________ 19____ .

	Client	Spouse	Combined
Assets			
Cash			
GICs/Short Term Deposits			
Securities			
Stocks			
Bonds			
Mutual Funds			
Other			
RRSPs			
RRIFs			
Pension Plan			
Annuities			
Life Insurance			
Cash Surrender Value			
Face Value			
Real Estate			
Principal Residence			
Other			
Business Investments			
Personal Property			
Other			
Total Assets			
Liabilities			
Mortgages			
Principal Residence			
Other			
Bank Loans			
Car			
Other			
Credit Lines			
Other Loans			
Last Expenses			
Total Liabilities			
Net Worth (Assets-Liabilities)			

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