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COMMENT

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WILL WORDING

A last will and testament can contain verbiage and phrases that are not commonly used in everyday conversations. These words have a very specific meaning, providing direction to the executor on how the estate is to be administered and distributed.

Two terms that appear in many wills, per stirpes and per capita, are used to describe the distribution of assets if designated beneficiaries predecease the estate owner.

Per Stirpes: This phrase provides for division of property through "lines" of descendants. A *per stirpes* distribution allows a beneficiary's entitlement to be distributed to his or her own heirs if that beneficiary dies before the testator. Consider the example of Zen who leaves the residue of his estate, valued at $300,000, equally to his three children, Alice, Bill and Carl. His will goes on to say that, if any of his children do not survive him but leave "issue" surviving, the share that would have passed to that deceased child will instead pass to that child's issue in equal shares *per stirpes*. ("Issue" in this context means the child's descendants.) If Zen's three children were all living at the time of his death, then each would share equally in the $300,000 amount. If, however, Carl predeceases Zen and is survived by his own two children, Jen and Kris, then Carl's $100,000 entitlement is distributed equally to Jen and Kris, with each receiving $50,000. Alice and Bill would each receive $100,000.

Per Capita: This phrase describes the division of property based on an equal amount "per head" for all who inherit. As such, if a beneficiary within the named group predeceases the testator, that beneficiary's share of the testator's estate is divided amongst the surviving beneficiaries of that named group. Consider the same net estate of $300,000, but this time Zen leaves his estate to his three children, Alice, Bill and Carl, who are then alive, in equal shares per capita. In this situation, if Zen's three children were all living at the time of his death, then each would share equally in the $300,000 amount. However, if Carl predeceases Zen, then Zen's estate would be divided equally between Alice and Bill, who would then each receive $150,000. Carl's children would not be beneficiaries of Zen's estate in this example.

Beyond legal words as outlined above, two common will planning concepts are the staged distribution and the gift-over.

Staged Distribution: Testators commonly use a staged distribution strategy to provide an inheritance gradually, allowing the beneficiary time to learn how to handle larger sums of money. Using this method, a testamentary trust would be used to give the inheritance to the beneficiary at several pre-defined points in time. For example, Tom received a $1,000,000 bequest from his mother's estate. The will stipulated that Tom should receive one-quarter of the estate balance at age 19, one-third of the remaining

balance at age 25, one-half at age 30 and the remaining amount at age 40.

Gift-over: The staged distribution strategy planned by the testator can potentially be frustrated by the beneficiary, because it is possible for the beneficiary to approach a court and have the entire inheritance paid out all at once. One strategy to overcome the beneficiary's opportunity to collapse the trust is to provide for a gift-over provision. This type of provision is designed to provide for any remaining amount to be paid to another beneficiary if the first beneficiary does not survive to the end of the distribution plan. Continuing the above example, a gift-over provision could be added that names a charity as the subsequent beneficiary if Tom does not survive to age 40. The existence of this other beneficiary prevents the court from simply paying the full amount of the estate out to Tom at his earlier application.

While your financial advisor may not be qualified to write a will, he or she may review your written plan to help ensure that it matches your objectives.

I/R 8500.00

PLANNING IN ADVANCE HELPS TO MINIMIZE CONFLICT

Sometimes, estate planning strategies depend on the co-operation of the survivors in order to achieve the individual's intended outcome. However, co-operation may be difficult to obtain after the fact, especially if the survivors are caught by surprise. As such, there is great value to be gained when individuals take the time to discuss their estate plans with beneficiaries in advance.

Registered Retirement Savings Plan

Sometimes, the assets of a registered retirement savings plan (RRSP) flow through the estate to the intended beneficiary because it may be more desirable to the overall estate plan. To accomplish this, the RRSP proceeds would be payable to the estate (i.e., there would be no direct beneficiary designated in the RRSP) and the will could direct that the estate pay the amount out to the intended beneficiary.

If the intended beneficiary is the surviving spouse or a financially dependent child or grandchild, an issue may develop if the spouse or the child's guardian needs to co-operate with the executor in making the joint election to have some or all of the funds qualify as a "refund of premium." If co-operation is not achieved, then the beneficiary might end up with the RRSP funds while the estate (and any residual beneficiaries) would bear the associated income tax liability. (Note, though, that proper will drafting could give the executor the flexibility to match the flow of funds with the imposition of tax, thus avoiding the need for co-operation.)

Equalization of Inheritances

Many estate plans are developed with the intention of treating each of the children fairly. However, the issue as to how one defines "fair" can give rise to many interesting outcomes. The testator's intention of a fair distribution should be reflected in the will, while the testator's children may each have their own view of what they consider to be fair. Does fair mean equal with respect to total monetary value of the inheritance? Or does fair take into account the risk-adjusted monetary value and the effort required to earn an income from the inheritance?

Consider the situation where Sam has bequeathed the shares of his business, valued at $2,000,000, to his youngest child Kelly who works hand in hand with Sam. The success of the business is highly dependent on Sam's involvement, although he has become increasingly comfortable that Kelly has garnered a strong grasp of the business. In addition, Sam had bequeathed to his oldest child, Wesley, a life insurance policy with a face value of $1,000,000.

Kelly has a much riskier investment and must work in the business in order to earn an income from that operation. Wesley, on the other hand, can simply invest the insurance proceeds and still earn an income by working elsewhere.

The issue of co-operation between the two children could arise if Wesley decides to challenge the estate with the demand for half of everything, rather than what would appear to be a one-third inheritance. The issue of fair versus equal is an important concept that warrants advance discussions with family

members in order to minimize unanticipated consequences for the estate and long-term family dissension.

Specific Bequests

Some estate plans provide for a particular asset to be given to a specific beneficiary. Thought is given as to what each beneficiary receives and the testator generally plans ahead for fairness amongst his or her beneficiaries.

An issue can obviously arise if the testator no longer owns the asset associated with the specific bequest at the time of death. When the asset no longer exists within the estate and there is no subsequent direction, the intended beneficiary generally receives nothing. To minimize the possibility of conflict, some testators provide specific direction in the event that these circumstances occur. The direction may simply be an explanation clarifying that it is the testator's intention that if the asset no longer exists, the beneficiary is to receive nothing. Alternatively, the will can specify that it is the testator's intention to provide a substitute asset. This additional statement can add clarity and avoid ambiguity, thereby reducing the possibility of a challenge against the estate.

Jointly Held Property

Some estate plans utilize the strategy of joint ownership, which can serve as a substitute to a will, in order to provide inheritances to intended beneficiaries. The ownership of property held through joint tenancy automatically passes to the surviving co-tenant(s) in equal shares, outside of the deceased tenant's estate. Thus, when developing an estate distribution strategy, the testator needs to consider assets that will form part of his or her estate as well as those assets that will pass automatically outside of the terms of the will.

An issue could develop if the beneficiary who receives property outside of the will also seeks to receive an equal share of the property that passes through the will. In such a case, one beneficiary could receive a great deal more than the other beneficiaries where that was not the testator's intention.

There are no hard and fast rules to govern how an individual can best achieve his or her estate plan. Even after the estate plan has been well thought through and pen put to paper, the additional step of communicating in advance with beneficiaries can help to ensure that they appreciate and accept the testator's goals and objectives behind the distribution plan.

I/R 2500.00

INSURED REDEMPTION STRATEGY

Corporate-owned life insurance can provide cash for various purposes following the death of the insured shareholder or key employee. It can produce even greater value when used as an integral element in a planning strategy that reduces income taxes.

A planning technique referred to as the “insured redemption strategy” utilizes corporate-owned life insurance to reduce taxes in the deceased shareholder's estate in addition to providing a death benefit. This strategy is quite complex and generally involves the redemption of shares from the estate using the proceeds of life insurance and promissory notes. The following discussion outlines the steps in very broad terms and without discussing the mechanical details of the rules.

The approach is to redeem shares with a value twice the amount of the credit created in the capital dividend account (the credit is equal to the life insurance proceeds less the adjusted cost basis of the policy to the corporation). This redemption will trigger a deemed dividend, half of which can be elected as a capital dividend (which is not subject to tax), while the other half will be treated as a taxable dividend. The redemption will also trigger a capital loss in the estate. While the “stop-loss” rules will have to be considered, the taxable dividend triggered should negate their potential impact. This means that the capital loss triggered in the estate can be carried back to the terminal tax return and used to reduce the capital gain triggered by the deemed disposition rules. While the taxable dividend realized in the estate will create an income tax liability, the capital loss carried back will create some tax shelter. Consider the following example:

Shares of ABC Inc.: $3,000,000 fair market value and accrued capital gain
Corporate-owned life insurance: $1,000,000 (assume zero ACB)

	($)
Terminal Tax Return	($)
Capital gain	3,000,000
Taxable capital gain	1,500,000
Estimated tax thereon (45%)	675,000
Estate's Tax Return	
Redemption	2,000,000
Deemed dividend	2,000,000
1/2 elected as capital dividend	1,000,000
1/2 would be a taxable dividend	1,000,000
Estimated tax thereon (30%)	300,000
Deemed proceeds	zero
Estate's ACB	2,000,000
Capital loss	2,000,000
Adjustment for stop-loss rules	zero
Capital loss carried back	2,000,000
Revised Terminal Tax Return	
Capital gain as filed	3,000,000
Capital loss carried back	2,000,000
Net capital gain	1,000,000
Taxable capital gain	500,000
Estimated taxes thereon (45%)	225,000
Original tax liability	675,000
Revised tax liability	525,000
Savings	150,000
As a % of life insurance	15%

The net effect is that for every $1 of life insurance, the taxes can be reduced by about 15 cents. This 15 per cent can be calculated as the difference between the top marginal tax rate and the effective tax rate on dividends in the individual's province of residence.

The insured redemption strategy is complex and the above illustration looks at part of the picture where the insurance proceeds are less than half of the accrued income tax liability. It is important to keep in mind that future tax consequences will also occur when the estate disposes of its remaining shares. The insured redemption strategy can also create a whole other set of considerations where the insurance proceeds represent a higher proportion of the accrued tax liability on the shares.

Life insurance can provide a tremendous amount of value to an individual's estate. Tax planning with corporate-owned life insurance can enhance the intrinsic value of life insurance with tax savings, but can be a very complex process.

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Contributors to this issue of Comment:

James W. Kraft, CFP, CLU, CH.F.C., CA, MTAX, TEP
Deborah Kraft, CFP, CLU, CH.F.C., TEP

Published by:

CLU Institute
350 Bloor Street East, 2nd Floor,
Toronto, Ontario M4W 3W8
P: (416) 444-5251 or 1-800-563-5822
F: (416) 444-8031
www.cluinstitute.ca • info@cluinstitute.ca

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