CONSIDERATIONS FOR EXECUTORS AND ESTATE TAX PLANNING

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A little bit about me and FVS…

- Have roots in the community, both parents are in Westlock Area, my in-laws are as well.
- I moved back to Westlock with my family and have been working with FVS since 2005. Became a partner in 2008.
- We assist a number of clients with estate tax planning each year.
- We complete a number of estate tax returns and trust returns annually as well.
- Tax rules are changing constantly, we attend professional development sessions regularly to stay on top of any changes.

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I’m now the Executor of an estate, now what? How do I get started?

- Accountant will require a copy of the will and death certificate.
- Executor will be required to sign an authorization form for the deceased that the accountant can send to CRA with the will and death certificate to access the deceased’s accounts online.
- Accountant will require a listing of assets with their fair market values at the time the person passed away to prepare the final tax return(s). If the will requires probate then that listing is a good place to start. If probate is not required a separate listing will be required. Sometimes financial institutions will require probate, and sometimes if the deceased owned certain property probate is required. ***Talk to the lawyer to see if probate is required.***
- How does the executor value the assets? For things like investments, investment advisors can provide the information. For things like land and equipment, more due diligence is required. Consultation with local realtors and equipment dealers is a good first step to gathering this information.
- What about the original cost of assets? Gains and losses are calculated at the sale price less original purchase price less costs to sell. This can be a tricky one for an executor if information is not readily available.
- It is my experience that if the deceased individual had a good accountant you stick with them to prepare the final returns. That person will have some history with the deceased and will have some idea about assets held at death / other tax plans the person may have had in place. Plus, they may have online access to CRA.

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What is the deadline for filing the final tax return of a deceased individual?

- The deadline for filing the terminal return is the later of April 30th (June 15 for self employed individuals) of the following year or six months after the date of death.

- In most cases if the deceased was married / living common law it is best to prepare their final tax return together at the same time as their spouse to take advantage of planning opportunities such as pension splitting, tax credit transfers, etc.

- Rights and things returns are due by the later of:
  - One year after the date of passing
  - 90 days after the Notice of Assessment or Reassessment of the Terminal Tax Return.

NOTE THE TAX PAYMENT IS DUE BY APRIL 30TH OF THE YEAR FOLLOWING THE INDIVIDUAL'S PASSING WITH THE EXCEPTION OF SOMEONE WHO HAS PASSED AWAY NOVEMBER 1 – DECEMBER 31ST. THEIR FINAL TAX PAYMENT IS DUE 6 MONTHS AFTER THE DATE THEY PASSED AWAY.

Executor compensation

- Executors are entitled to take compensation for completing their duties for the estate. Though, they do not have to do this.
- My research indicates there are different factors to consider for executive compensation, for example:
  - A) Value of estate
  - B) Revenue and expenses
  - C) Complexity of work
- Executors are also able to be reimbursed for out-of-pocket expenses incurred (like travel, parking, etc).
- Note that executive compensation is a taxable benefit for the executor and is subject to CPP, but not EI. The Estate needs to make remittances for tax and CPP deductions.
- The Estate must file a T4 return and a tax slip must be provided to the executor when the fees are paid. The estate's accountant can assist with this.
- **EXCECUTOR – SPEAK WITH THE LAWYER IF YOU ARE CONSIDERING TAKING EXECUTOR COMPENSATION.**

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Clearance certificates, should the Executor apply for one?

- The Executor(s) is(are) legally responsible for ensuring the Estate pays its debts to the extent it is able prior to disbursing assets to the beneficiaries.

- A Clearance Certificate is a document from CRA that indicates the Estate has fulfilled all of its income tax liabilities and no further amounts will be owed.

- Obtaining a Clearance Certificate is one way of ensuring that the deceased person’s tax liabilities have been paid prior to the disbursement of all assets.

- If assets are disbursed and the Estate owes income tax, it is the Executor’s responsibility to ensure the debt is paid. It could be extremely difficult to get monies back from the beneficiaries to pay any outstanding tax debts after the monies have already been disbursed.

- The accountant can help with the application for clearance after all tax returns for the Estate have been assessed.

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What does the Income Tax Act say about taxes on death?

- The first rule is that when someone passes away, they are deemed to have disposed of their assets at fair market value unless there is an exception to this rule.
- Exceptions include:
  - Transfers of assets to your spouse. There is an election to dispose of an asset to the deceased's spouse at fair market value that can be filed with the final tax return. This may be useful in some situations.
  - Transfers of qualified farm property to children. Land / shares of a Qualified Farm Corporation / depreciable assets / farm partnership assets. You can make an election to transfer at any amount between original cost / depreciated balance and fair market value on the final tax return. No formal election is required to be filed.
  - In some instances RRSP's can be transferred to a RDSP (Registered Disability Savings Plan) for a financially dependent child or grandchild.

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What dispositions have to be reported on a terminal tax return? Common items include:

- Gains / losses on stocks / mutual funds / other investments that were not in a tax-free savings account or a registered pension plan.
- Gains / losses on rental properties
- Gains /losses on farmland, equipment, automotive assets, etc.
- Fair Market Value of RRSPs/RRIFs/LIRAs at the date of passing
- Gains (not losses) on personal use property **with an original purchase price of over $1,000**. This would include vehicles, furniture, boats, etc. Also included are properties in other countries, snowbirds with properties in USA or Mexico for example. Gains on these properties may also be taxable in the country in which they are located. If we have a tax treaty with that country, the deceased will get credit for the foreign tax paid when they file their Canadian return.
- Gains (not losses) on listed personal property **with an original purchase price of over $1,000**. (this would include jewelry, art, antiques, coins, etc.)
- **Your interest in your principal residence must be reported, though any gain is exempt for income tax purposes. The penalty for not reporting this deemed disposition be up to $8,000! Remember, if you have more than one residence where you normally reside in a year, you have to chose 1 for each year. CHOOSE THE ONE WITH THE LARGER GAIN! (EXAMPLE, LAKE COTTAGE)**

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What dispositions do not have to be reported on a terminal tax return?

- Tax free savings accounts. (note the deceased's TFSA can be transferred to the spouse's TFSA and continue tax exempt status regardless of the spouse's contribution room)
- Guaranteed investment certificates
- Bank accounts
- Listed personal property and personal use property that have losses in value
- Life insurance proceeds (**BEWARE – some life insurance policies are not straight life insurance and have investments embedded withing them that may be taxable)**
- The CPP death benefit **is not reported** on the final tax return. Either the beneficiaries have to report their respective portions of the benefit or a separate T3 Trust Return can be filed to report the benefit.

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What about trust returns after the terminal return is completed but assets are not yet distributed?

- It is CRA's administrative position that any income and gains incurred in the year after the person passed away (i.e., the "Executor's Year") are to be reported in the hands of the beneficiaries, unless the beneficiary objects to this, then the estate must report the amounts. It is our experience that CRA will accept either way of reporting (i.e., a T3 Trust Return or the beneficiaries reporting in their returns.)
- If assets are not distributed to beneficiaries after the Executor's year, then all income and gains should be reported on a T3 Trust Return.
- Trusts do not have access to the basic tax credit, though they do have graduated rates of income tax like individuals for the first 36 months of their existence. This gives the executor time to disburse of the remaining assets. After the 36 months, all income earned in the trust is taxed at the top marginal rate unless it is exempted (example – Qualified Disability Trust).
- Graduated rate estates can chose any year-end, does not have to be December 31st.
- If beneficiaries are minors, the assets must remain in trust until the beneficiaries turn 18 unless a later age is specified in the person's will. **BEWARE! IF YOU ARE THE EXCECUTOR, YOU COULD BE THE TRUSTEE AS WELL FOR MINORS. YOUR DUTIES MAY GO ON LONGER THAN YOU HAD ANTICIPATED.**
- To avoid the top marginal rate in a trust after 36 months, income can be allocated from the trust to the beneficiaries. Note after the 36 months the year-end of the Trust generally reverts to December 31st.

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Is an inheritance taxable?

- Generally speaking, by the time the beneficiary receives their inheritance from the estate tax has already been paid on the fund and **therefore the receipt is not taxable.**

- Trustees of testamentary trusts (i.e., when the estate has activity past the date of the person's passing) can allocate income to beneficiaries and then those income amounts are required to be reported on the beneficiary's tax return with the issuance of a T3 Trust Income slip from the Estate.

Planning points to consider

- **CAUTION: When naming beneficiaries for registered pension plans (RRSPs / RRIFs/ LIRAs / etc.) note that the bank / investment company will send the proceeds straight to the beneficiary. However, in almost all cases it is the estate that will owe the tax! If the registered pension plan proceeds are not going direct to your spouse's registered pension plan, consider naming your estate the beneficiary so the funds follow the tax liability.**

- **BEWARE – Potential issues for double taxation on those who pass away owning shares of a small business corporation. Tax work can be done to mitigate these risks. Do not be in a hurry to distribute corporate assets without talking to the accountant first and making a plan.**

- Making use of the capital gains exemption of qualified small business corporation shares / qualified farm property.

- Splitting pension income with your spouse.

- Charitable donations to be made by the estate per instructions in their will (both cash and other assets). Can be carried back 2 years to the second last tax return and the final tax return of the deceased. The election to do this must be made on the T3 Trust Return and can be done up to 60 months after the person has passed away.

- Rights and Things tax return. This is a separate tax return that can be filed on death that allows the use of personal tax credits a second time and can result in tax savings. Rights and things consist of items of income which have been earned and are receivable at the date of death. They would include things such as:
  - Unpaid vacation pay
  - Declared and unpaid dividends
  - Deferred crop / cattle sales for farmers who are reporting on a cash basis.
  - Crop / cattle inventory for farmers who are reporting on a cash basis.

- $10,000 tax free death benefit to beneficiary of an individual from a corporation where the person was an employee. (consider in the case of individuals who have their own corporations)

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Where do I start with my estate tax planning?

- **Make sure you have a will** - Review your will every few years to make sure the instructions contained are still relevant to your situation.

- **Choose an Executor** – things to consider:
  - Does the person have a vested interest in the outcome of the estate.
  - Do they live nearby so that they can administer your estate easily? With electronic communications / electronic signing, etc. this is getting easier.
  - Do you want more than one executor? Advantages and disadvantages to both.
  - Be careful with executors that live in other provinces besides the one you live in.

- **Know where you want your assets to go.** It is not the job of the lawyer / executor / accountant to make these decisions, though they can advise of any risks your plans may have.

- **CONSULT YOUR ACCOUNTANT BEFORE FINALIZING YOUR WILL TO AVOID UNINTENDED TAX CONSEQUENCES!**

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QUESTIONS?

DEATH AND TAXES