Holding Investments inside a Company – Taxes upon Death

In the absence of planning, when an individual passes away owning shares of a private company, they could be exposed to double or triple taxation.

This extra taxation could occur at several points as the deceased's assets pass through the estate and get distributed among the heirs and beneficiaries:

- In the hands of the deceased upon death, because of the deemed disposition rules
- Within the corporation itself as it sells the investments
- In the hands of the heirs and beneficiaries as amounts are distributed from the company

When an owner of shares of a private company passes away, there are valuable strategies that can effectively reduce the total taxes payable on the corporate assets that were owned by the deceased. Post-mortem planning considers the collection of tax planning strategies that can be applied following death to help minimize the overall tax bill on the remaining assets and the income these assets generate.

The tax rules involved in tax reduction strategies after death are complex. Professional expertise is required to effectively execute and realize the available tax saving. The following is a simple example to illustrate the need for planning.

Mr. Smith owns a company and inside the company is a $1,000,000 investment portfolio from when he sold his business. The holding company's adjusted cost base of its investment portfolio is $700,000. At the time of death, the private company shares are worth $1,000,000. The table illustrates a summary of tax liabilities with and without planning.

Tax Liabilities

	No Planning	With Planning
Deceased	$225,000 (45%)	$225,000
Company	$28,500	$0
Heirs	$287,500	$0
Bottom line (after tax)	$459,000	$775,000

Continued

The bottom line after implementing post-mortem planning is that the total income tax liability would be reduced to $225,000. This much lower amount is based on the tax liability realized on the terminal tax return of the deceased. The children would be able to retain $775,000 after tax, a significant tax savings of $316,000.

What owners of private corporations can do now

Even though post-mortem planning is not implemented until after death, it is very important for owners of private companies to provide the ability for their future executors to implement the strategies discussed above. This will allow their executors to efficiently minimize taxes, preserve inheritance values and leave their beneficiaries with more. Specifically, key areas that should be put in place now for successful post-mortem planning include:

- Choose an effective, knowledgeable and prepared executor for the estate; consider a trust company
- Establish or update the Will to ensure it provides the executor of the estate with the powers required to make the necessary tax elections within the post-mortem plan
- Commit to reviewing and updating the post-mortem plan when material changes occur for the private company, its owner, or for the beneficiaries
- Ensure that the future executor is familiar with knowledgeable tax professionals who specialize in complex estates involving private company shares.

TIP

As the tax rules highlighted in the above example are very complex, professional expertise is required to effectively execute and realize the available tax savings.

For more information, speak with your BMO financial professional.

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