Financial Planning

Tax and Estate Planning

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In Canada, there is no inheritance or estate tax. However, any capital property owned by the deceased is deemed to have been disposed of at fair market value immediately prior to death. The deemed disposition will trigger taxation of capital gains. Any disposition of capital assets (including deemed dispositions) made in the year prior to death must be reported on the deceased's final tax return. The final tax return must be filed for the deceased by the executor or administrator of the estate.

What is a "deemed disposition" and why does it matter?

When someone dies, the government treats any property or items owned at the time of death as though it was sold on the day before which the person died. For example, if the deceased owned stock, it would be treated for income tax purposes as though the stock was sold on the day before the person died.

In many cases, this deemed disposition of property triggers additional capital gains tax to be included in the deceased's final income tax return. If a property would have qualified as the taxpayer's principal residence, the principal residence exemption may be available to reduce or eliminate capital gains incurred on the disposition of that property.

The deemed disposition can be deferred until the date of death of the surviving spouse if the deceased's assets pass to the surviving spouse, or to a Qualifying Spousal Trust for the benefit of the surviving spouse.

What is a Qualifying Spousal Trust?

Capital gains tax may be deferred by using a financial/estate planning mechanism called a trust Qualifying Spousal Trust (QST). For spouses, creation of a QST allows the payment of capital gains tax to be deferred until both spouses are deceased, or until the assets held within the trust are disposed of to anyone other than the spouse. Detailed estate taxation planning – including setting up trusts – should be undertaken with the assistance of a licensed professional.

A QST allows an individual to provide for a surviving spouse during their lifetime, and to have any remaining assets revert back to the original testator's chosen beneficiaries. The surviving spouse will be able to use the assets of the QST to their benefit during their lifetime.

How are capital gains taxed?

Capital gains rates depend on the adjusted cost base (i.e., the purchase price plus any capital costs) of a property, the gain or loss on the deemed disposition, and whether the estate or the beneficiaries named under the deceased's will are liable for the tax. Each of these factors will affect the amount of tax paid.

If taxed through the estate, the estate can benefit from favourable tax rules. Generally, 50% of capital gains are added to the personal income of the deceased and taxed accordingly. Where distribution of assets has occurred within a year, the capital gains will be taxable as part of the beneficiary's income.

Will my beneficiaries have to pay tax when I am gone?

In most cases, inheritances are received after-tax. For instance, if a beneficiary is left a house, they will pay no tax on receiving the property. Once the house is in their hands, they will be liable for standard taxes such as property tax and potentially capital gains tax if the house is sold and not used as a primary residence.

Note that some jurisdictions tax beneficiaries by way of an inheritance tax. As such, it is possible that a beneficiary may be subject to an inheritance tax, and the Canadian estate will be subject to capital gains tax on deemed disposition of assets. A beneficiary residing in a foreign jurisdiction should contact a licensed tax professional for advice on how different tax systems will impact estate planning.

Capital gains tax may be deferred by using a QST (see above). Detailed estate taxation planning including setting up trusts should be undertaken with the assistance of a professional.

How are my RRSPs or RRIFs taxed when I die?

When the holder of an RRSP or RRIF dies, the remaining balance is treated as income to the deceased in the year of death from a tax perspective. If the RRSP or RRIF can be transferred to the surviving spouse, taxation of the RRSP or RRIF can be deferred until the death of the surviving spouse.

What are probate fees/estate administration tax?

Probate fees (known in some provinces as probate tax, probate charges, or estate administration tax) are fees or taxes charged in relation to obtaining a grant of probate (or Certificate of Appointment in Ontario). The name of the fee/tax and amount of tax charged varies from province to province and territory to territory.

Are there any exemptions from probate fees?

The list of items and estates eligible for exclusion from probate fees varies from province to province. Estate planning can be undertaken to minimize probate fees, one example is through the use of Multiple Wills.

ACTION ITEMS FOR YOU TO CONSIDER:

1) It's important to keep your Will and Powers of Attorney up-to-date so it always reflects your current wishes in the event of an emergency. If you haven't created your Will or Powers of Attorneys yet, it would be a good time now.

2) Depending on your circumstances and the complexity of your estate, you may want to consider appointing a trust company as a corporate executor. Please refer to the attached report on Appointing a Corporate Executor.

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