# TAX PLANNING FOR AN INHERITANCE

Having a Will, keeping it up-to-date, and minimizing taxes payable by your estate are all important aspects of estate planning. But maybe you would like to take your estate planning that "extra mile" and provide an opportunity for your spouse, children or grandchildren to save taxes in the future.

Including trusts in your Will can give your beneficiaries a greater after tax return on the investment income earned from their inheritance. It's like putting your family's inheritance in a "tax shelter." And if you are expecting an inheritance from your parents, this might be something they could consider in their Wills to reduce *your* tax bill in the future.

"Testamentary trusts," trusts created on death (usually in your Will), have one unique tax characteristic: they are taxed as a separate individual, and have the same graduated tax rates. Income earned in the trust and paid to beneficiaries can be taxed at the lower marginal tax rates of the trust, even if the beneficiaries are taxed at the higher marginal rates.

Depending on the province and the income of the trust, the tax saving on the trust's lower rates can be up to approximately $12,000 *every year*. The maximum tax saving is on the first $30,000 of income: the level where the income is taxed is at the lowest marginal rates. Even more savings can be generated where multiple trusts for separate beneficiaries are set up, or where the trust permits income to be paid, or "sprinkled" on a discretionary basis to other family members who themselves may be taxed at lower rates. These can include the child's spouse, children and grandchildren and so on. Usually a family trust such as this provides that the distributions from the trust be at the discretion of the trustee to provide maximum flexibility and tax savings.

Consider this strategy if you expect that the inheritance you leave might be more than your children or family members will (or should) spend on debt reduction and lifestyle changes – e.g. if the inheritance will be invested. To determine this, you need to estimate the approximate value of your estate, and anticipate the financial position of your children or other beneficiaries at the time they will inherit.

Remember, by the time your children receive their inheritance, their income may already be at or close to the highest marginal tax rate threshold. Additional investment income will be taxed at the highest rate. If this income first passes through a testamentary trust you have set up in your Will, the tax rate can be reduced, and your child can still receive the income. If your beneficiaries receive the inheritance directly, they cannot create the trust themselves to access this tax saving; it must be done in your Will.

There are many technical details involved in deciding to use testamentary trusts to reduce income tax for surviving beneficiaries. For example, unless the trust is for a spouse, unrealized capital gains will be taxed every 21 years in the trust. For this reason many of these trusts have an option to terminate and distribute all property before the 21 year deadline. The final distribution of the trust property can be set

out in your Will, or the trustee, such as your child, can be given the right to determine the final capital beneficiaries, either during the child's lifetime, or in the child's Will.

Advising on the tax treatment of testamentary trusts requires the skill of a professional who specializes in estate planning. Your Investment Advisor can help introduce you to an estate planning professional.

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