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GETTING PERSONAL CANADA: Death Doesn't Need To Be Taxing

By Caroline Van Hasselt Of DOW JONES NEWSWIRES

TORONTO In life, death and taxes are the only two certainties.

So, the big question is, how can heirs reduce the tax burden left by their parents' estates?

The answer lies in good estate planning. That means checking to see if it's worthwhile to include a testamentary trust in your will. Such trusts take effect only upon someone's death and can, if used correctly, offer opportunities for tax savings because they're taxed as an individual filer. The income earned in them are subject to the same graduated tax rates that individuals get.

"It's the most underutilized estate-planning tool out there," says David Phipps, a certified financial planner at Assante Wealth Management in Ottawa. "It may provide a huge savings, yet I rarely see them used."

For example, take the baby boomer, at the peak of their earnings potential, with parents who have built up a C\$1 million nest egg, Phipps says. When they're both dead, the heir pays tax on the income generated from the investment account. If he or she has other income and is already in a high tax bracket, that investment income will be taxed at that high rate. In Ontario, the highest tax rate is 46.4%. But, if the will had directed the account to be held in a testamentary trust, the investment income would be taxed at graduated tax rates, which vary from province to province. The trust files a separate tax return with the year-end usually coinciding with the person's death.

"Don't send the money straight to the child. Put it in a testamentary trust," says Phipps.

The tax differential depends on the type of income, be it interest-bearing, dividend or capital gains.

While there are associated costs, such as legal and probate fees, they're minimal when compared to the potential annual tax savings, Phipps says.

Manu Kakkar, a Montreal tax specialist, warns that it's important to seek expert advice to ensure the trusts are properly set up and aren't rendered offside under certain transactions, such as the trust incurring debt to make investments. "It's not just a one-trick pony," says Kakkar.

Typically, these trusts are used by parents of young or disabled children, or to keep a property, like a cottage, in the family without the kids fighting over it, says Ernst & Young tax specialist Gena Katz. The will can also specify multiple testamentary trusts. As well, the trusts don't last forever. Every 21 years they are deemed to dispose of all the property, she says.

Because heirs don't want to appear greedy, or self-serving, families avoid talking about death and taxes. But they really should try to optimize their parents' estates, says Phipps.

"Even in a complicated family situation, it's certainly appropriate for an individual to go to his parents, and say, 'assuming you're going to leave me something, you might want to talk to your lawyer, or an expert, about leaving it to me in a testamentary trust because it will save me a pile of tax,'" he says.