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Intergenerational wealth transfer: keys for success

By AdvocateDaily.com Staff

Inheritances can be a windfall, but how the next generation manages that estate is a critical part of the process, say Toronto estate lawyer Ian Hull and INTEGRIS Pension Management Corp. founder and CEO Jean-Pierre Laporte.

The way wealth is transferred could well impact the bottom line, but issues such as taxes can be mitigated with advanced planning, they tell AdvocateDaily.com.

That is particularly important now as Canadians are seeing a 50 per cent increase over what is being passed to the next generation over the past decade. A CIBC study published last year suggests Canadians can expect to inherit $750-billion from their aging relatives over the next decade.

Those higher inheritances can have an impact on the tone — and the volume — of litigation, says Hull co-founding partner of Hull & Hull LLP.

Therefore planning is integral, adds Laporte.

“We get the question all the time when people set up pension plans,” says Laporte. “’What happens when I die, how will I be taxed and what are the options?’ Especially in this environment where the federal government is looking under every rock for tax dollars, there will be more focus on tax.

“Those passing on wealth have to think long and hard when planning their affairs to avoid a huge tax bite,” he says.

The planning should also include efforts to help the next generation avoid litigation, they add. The more money at stake, the greater the chances are for the will to be contested.

Discussion with the heirs about what’s going to happen can make a difference down the road, they add. That could include how the wealth will be transferred and any sharing agreement among the heirs, says Hull.

If a cottage is left to several siblings, for example, how will they share its use and expenses should be made clear and could be part of an agreement. That’s in addition to figuring in capital gains taxes that are owed by the estate when it changes hands.

Focusing on pensions during the planning stage can make a big difference, says Laporte. Wealth accumulated inside a pension plan can be passed on to the next generation.

People who are working for the family business are taxed differently and they can avoid the probate fees and the deemed disposition that is inflicted on RRSPs going from one generation to the next or on corporate assets gifted through the will, he says.

“It generates a large tax liability that the heirs and beneficiaries might not have been thinking of. It wasn’t their money to start with, so they didn’t plan around it,” says Laporte. “They’re just suffering the consequences. And it gets worse if there aren’t any designated beneficiaries on record and the money drops into the estate and is, therefore, subject to probate in Ontario.”

But relatives working for the family business can make an intergenerational wealth transfer application to use inherited wealth inside the pension to fund their own retirement, he explains. In that scenario, they avoid probate fees.

A similar approach applies to a universal life policy or whole life policy.

Laporte and Hull point out that, without good estate planning, families might miss out on a huge amount of tax assistance, which can have a dramatic impact on the lifestyle of the survivors.

“It is one of the few planning tools left that has strong built-in tax advantages,” says Hull. “There are all sorts of loopholes that had been closed and this is one of them that seems to be still viable in the insurance industry.”

Adds Laporte: “I think it’s kind of a best-kept secret, but the flip side is millions of Canadians who work so hard to set aside wealth for their family are getting dinged on taxes needlessly.”

A large percentage of business owners qualify for products like Personal Pension Plans (PPPs), but few actually take advantage of that, Laporte says.

He points out that people with salaries as low as $70,000 — paid from their company — can take advantage of this approach. The one caveat is it’s reliant upon the business owner paying themselves a salary instead of dividends because dividends are not pensionable.

PPPs aren’t as pricey or heavily taxed as RRSPs and they have lower fees, Laporte says, and “They’re also tax-deductible."

Hull notes that pensions need to be included in estate planning as well. The lack of a designated beneficiary could complicate situations, particularly when family structures are altered, such as when there is a second marriage.

“There is an ability under pension statutes for a spouse to waive his or her entitlement to the survivor pension,” Laporte says.

“It could be a useful tool when you're thinking about succession planning. So maybe the spouse opts to waive the statutory pension, because they’re going to get the cottage and the stocks, and then pass the wealth on to the kids working for the business, tax-free.”

For those who have accumulated some wealth and who want to plan for future generations, Hull suggests communication in addition to planning is key.

“Don’t blindside people with your estate planning. Operate with some transparency,” he says.