Wills & Estates

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ESTATE PLANNING – REGULAR CHECK-UPS REQUIRED!
PART IV– CHANGES IN TAX LAWS

This is the fourth article in a four-part series on wills and estate planning.

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In the first three editions of *Estate Planning – Regular Check-Ups Required!*, we discussed how changes in your assets, changes in your family life and relationships, and changes in estate laws may require that you review and revise your estate planning documents.

As a general rule of thumb, we suggested that if your estate planning documents are more than three to five years old, it's time to review and up-date them.

Another reason to review your estate planning on a regular basis is that the tax laws applicable to estates change from time to time which may make prior plans and strategies no longer effective.

A number of recent changes in our tax laws have also affected estate planning strategies:

1. Prior to 2016, income earned in an estate and any trust arising as a result of death (a testamentary trust) was taxable at the graduated rates of tax applicable to an individual. As of January 1, 2016, graduated tax rates are available only for a graduated rate estate ("**GRE**") that meets certain requirements and for a maximum of 36 months after death.

   What this means is that for on-going trusts created by a Will, after the first 36 months, any income that is not taxed in the hands of a beneficiary will be taxed at the top tax rate, which is approximately 46% in Ontario. This puts an end to the income-splitting opportunity that made the establishment of many testamentary trusts attractive and as well, made many spousal trusts attractive. These allowed the potential for income splitting between the adult child and the trust or the spouse and the trust. Such structures will have to be re-thought.

   A GRE is only available to an estate. Prior to this change, an insurance trust created outside of the Will not only provided savings of probate fees, but also qualified as a testamentary trust to which the graduated rates of tax applied. This is no longer the case and such a trust does not qualify to be designated as a GRE. These strategies have to be revisited to determine whether the probate fee savings on the value of the insurance outweighs the income tax savings in the first 36 months if the funds form part of the GRE.

   Finally, you will quite likely want your estate to qualify for GRE status so that it can take advantage of 36 months' of graduated tax rates on income earned and, more importantly, because only a GRE can carry back estate losses to the deceased's terminal return, access new flexible charitable donation credit rules, and benefit from 0% capital gain inclusion on terminal return for donations of marketable securities. For these reasons, many estate planners are now including clauses in the Will specifically directing the Executor to consider electing that the estate have GRE status as well as a clause to preserve the testamentary trust status for 36 months after death.

2. If a beneficiary qualifies for the disability tax credit, a new trust called a "**Qualified Disability Trust**" or "**QDT**" can be established and should now be considered.

3. The major changes announced October 3, 2016 for the Principal Residence Exemption ("**PRE**") now affects trusts that hold the home. For tax years that begin after 2016, only eligible trusts may claim the PRE and if the trust acquires the property on or after October 3, 2016, the terms of the trust MUST also provide the eligible beneficiary with a right to the use and enjoyment of the property as a residence throughout the year in which the trust owns the property. This requires re-visiting Wills in which homes were set aside in trust to ensure that they will not be off-side of the new rules.

Your estate planning documents do not adapt to your changed circumstances or to changes in the applicable laws. Regular check-ups will ensure that your objectives (or changed objectives) will be met and that they will be met in a cost-effective and tax efficient manner.