

Aging Boomers up the Estate Planning Ante – Part I

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I remember where I was when Kennedy was shot; I watched the Beatles live on Ed Sullivan. Even so, I bristle when I see ads pandering to me and my fellow Boomers with old recordings fit for 8-tracks, not iPods. But when I saw a recent issue of a legal magazine featuring estate planning for greying Boomers, things began to sink in: when it comes to inheritances, we are rapidly going from the receiving end to the giving end.

But the usual estate planning content – updating your will, doing a power of attorney, a reverse mortgage here and there - misses a big point, namely that the demise of the older generation will involve the greatest wealth transfer in history (and there will be more than chump change left over when we Boomers ourselves leave the building).

Trouble is, this enormous wealth transfer is converging with an increasingly complex legal environment, particularly in the income tax area. This article presents some estate planning issues that will become increasingly important as wealthy Boomers age. As will be seen, the issues in play go far beyond traditional estate planning considerations.

U.S. Emigration

My generation and those which follow have unprecedented mobility, especially to south of the border. If the emigrant is from an affluent family, it is possible, if not likely, that he or she will have an interest in an investment-type company, perhaps real-estate related or the holdco of an operating company which has generated excess cash. Whether the interest is direct or indirect (e.g., through a family trust), the U.S. CFC and PFIC¹ rules, pertaining to “passive” income earned by foreign corporations, potentially come into

resident is one of many beneficiaries of a large *inter vivos* trust established, say, in Hong Kong. If there are no other Canadian beneficiaries, the usual FIE calculation may necessitate applying the deemed interest rate to the “designated cost” of the trust, which can be based on the trust’s entire gross assets.^{vi} And as I indicated in a fairly recent article,^{vii} similar rules also apply to a Canadian beneficiary of a non-resident estate.^{viii}

Also, as a result of the non-resident trust proposals, transactions between a Canadian resident and a non-resident trust/estate - even if indirect - must be reviewed very carefully. Various deemed contribution provisions may result in the trust being taxed like a Canadian resident – e.g., on its worldwide income^{ix}, if there is a “resident contributor”.

As can be seen from the foregoing, advising a Canadian beneficiary of a non-resident trust or estate may require nothing less than a detailed knowledge of the non-resident trust and FIE proposals - some of the most complex legislation around.

Deemed Disposition Rule – Twists for Generation Xers

The fact that there is a deemed disposition of shares and other assets passing to another generation is nothing novel (although the amount of taxes collected from this rule in coming years may be). What may change is the *post-mortem* planning strategy that may be best. In the past, the tax resulting from the deemed disposition rules was looked at as a wasted expense, especially where the underlying assets, e.g., the family business, would continue to be held by the next generation.

But is it? The affluence of recent years has changed attitudes, particularly the offspring of wealthy Boomers. The spectre of carrying on family businesses is often looked at as a burden rather than a privilege; instead, there may be increasingly more motivation to seek a more enjoyable life style, funded by family wealth. Where this is held at the

designated cost otherwise determined. In the case of an interest in a trust or estate, clause F (or D) of the proposed “designated cost” definition in subsection 94.1 would typically apply, so that, but for proposed subparagraph 94.1(2)(c)(ii), the designated cost otherwise determined would be based on the fair market value of the beneficiary’s interest.

^{vii} “Heartbreak Hotel – Foreign Estates and The FIE Rules”, by the author, *Tax Topics* report #1751, September 29th, 2005.

^{viii} The definition of “trust” in proposed subsection 94.1 indicates that “trust” includes, for greater certainty, an estate. The definition of “exempt interest” is to be expanded to include a participating interest in a non-resident entity if the non-resident entity is, during the period in its taxation year that the taxpayer held the participating interest, a testamentary trust that is an estate that arose on and as of a consequence of the death of the individual, and the particular time is no more than twelve months after the death of the individual. The twelve month period can be extended by the Minister.

^{ix} See “NRT Rules: Harsher Than You Think”, by the author, *Tax Topics* #1705, November 11, 2004. For a detailed discussion, see “Observations on Section 94”, by William Innes and Dessislav Dobrev, 2006 AC No. 36, which includes a list of transactions with a non-resident trust. Proposed subparagraph 94(3)(a)(iv) provides that a trust subject to (proposed) section 94 is resident for the purposes of proposed section 94.1 and is therefore excluded from the definition of “non-resident entity” in proposed subsection 94.1(1).