

Selected Legal Issues in
Wills & Powers of Attorney,
Succession, Trusts & Estates

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Association

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INTRODUCTION – Who are We?

- Basman Smith LLP is a 21-lawyer, full service downtown Toronto law firm
- Firm's focus is servicing owner operators of private businesses, high net worth individuals, families and executives in their legal needs
- Mary is one of the managing Partners and her area of practice is estate planning, estate administration, corporate/commercial law with a focus on private business owners – shareholders' agreements, partnerships, business succession and corporate reorganizations
- Karen is a Partner of the firm and her practice is focused on estate planning for young families and emerging professionals, residential and commercial real estate, and estate administration

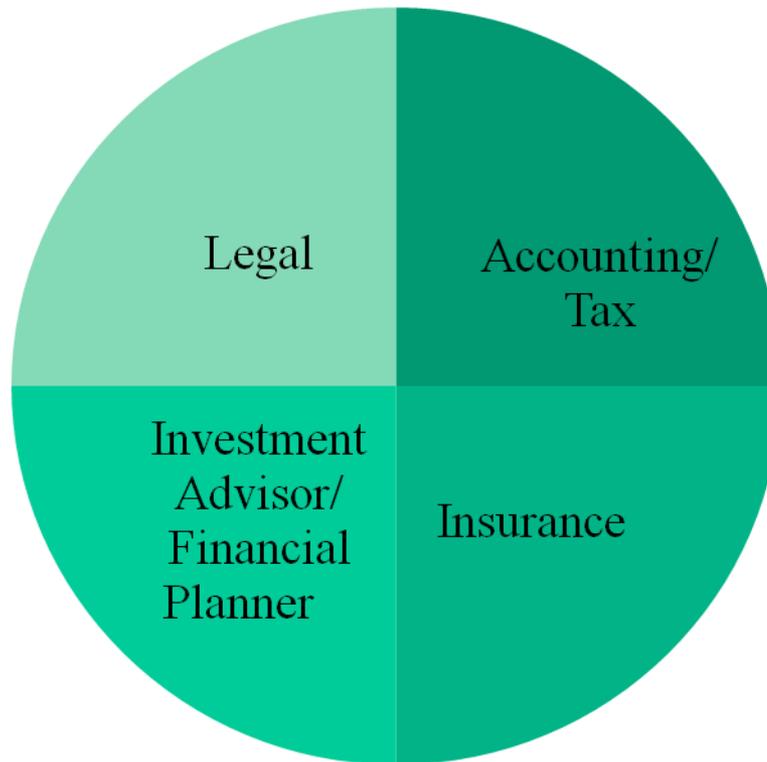
INTRODUCTION – What we Do?

- The Firm has a strong matrimonial presence with 1/3 of our lawyers practicing exclusively in matrimonial law
- Our work of planning for wealth transfer is intertwined with:
 - the preparation of domestic contracts
 - settlement of matrimonial disputes
 - settlement of business disputes
 - real estate transactions
 - unraveling corporate assets
 - corporate reorganizations
- We have expertise in dealing with complex and blended family situations

OUR ROLE

- We work as part of our client's professional team of advisors

Professional Advisors



OUR MANDATE

- Our role is limited to providing legal advice, we rely on you for the accounting and tax advice
- Our goal is to work collaboratively with our client's other professional advisors and to focus on the legal issues
- We look to ensure that our client gets comprehensive and integrated advice in their estate planning, succession planning and estate administration

PRESENTATION OUTLINE

- presentation will be focusing on key legal issues that arise in different life stages of a business owner's life
- presentation will NOT be on any tax issues
- we will focus on family law and estate planning issues
- we will be using a fictitious case study – Handout, our mutual client Hugo

PRESENTATION OUTLINE

Hugo's various life stages will naturally draw us into:

1. Existing estate planning documents - effect of cohabitation & marriage
2. First marriage mirror wills, POAs, POAPC, Insurance Trusts
3. Accumulation of wealth & growth of business – shareholders' agreement, estate freeze, *inter vivos* family trust , multiple wills, spousal & children testamentary trusts
4. Effect of separation & divorce
5. Second marriage - blended family considerations; “yours, mine and ours”
6. Mature second marriage – shifting goals
7. Succession plan for business and cottage
8. Estate administration issues

HUGO'S PROGRESSION THROUGH LIFE

Our Case Study Handout:

1. Hugo is 32, young business owner with existing estate planning documents and is cohabiting with Penny
2. Hugo and Penny get married
3. Hugo and Penny have their first child
4. At 42 Hugo and Penny have two more children; Hugo's business grows and he joins forces with a competitor to expand the business; Hugo and Penny accumulate wealth
5. At 54 Hugo buys out his partner
6. Hugo and Penny separate & divorce
7. At 60 Hugo meets Bernadette, they marry; blended family
8. Hugo and Bernadette have a late life child
9. The kids all grow up
10. At 67-70 Hugo retires
11. At 78 Hugo passes away

Effect of Living Common Law on Estate Planning Documents

- a common law relationship does not revoke a Will
- a common law relationship does not revoke the beneficiary named on an RRSP/RRIF; pension; TFSA or life insurance
- a common law relationship does not revoke a Power of Attorney or Power of Attorney for Personal Care
- a common law relationship does not confer equalization rights under the *Family Law Act* (“FLA”)
- a common law relationship will confer personal care decision rights if there is no Power of Attorney for Personal Care in place and will confer standing to apply as a statutory guardian to replace the Public Guardian and Trustee

Effect of Marriage on Estate Planning Documents

- marriage will revoke a Will unless the Will is made specifically in contemplation of marriage
- marriage does not revoke the beneficiary named on an RRSP/RRIF; pension; TFSA or life insurance
- marriage does not revoke a Power of Attorney or Power of Attorney for Personal Care
- marriage does confer equalization rights under the *FLA*
- marriage will confer personal care decision rights if there is no Power of Attorney for Personal Care in place
- NOTE: a Will made in another jurisdiction dealing with real property may not be affected by this!

Rights On Death With or Without a Will

COMMON LAW SPOUSE

- no automatic right to a share of the estate under the will or under intestacy laws
- no equalization under the *FLA*
- must look to equitable remedies of unjust enrichment (new concept of “joint family venture”) and/or dependant’s relief under the *SLRA* which includes claw back provisions for life insurance proceeds and RRSP/RRIF

MARRIED SPOUSE

- the right to elect between the provisions under the will or the equalization payment under the *FLA* when the deceased dies with a will or to elect between the intestacy entitlement (\$200,000 preferential share & portion of the residue depending on the number of children; all if no children; ½ if one child; 1/3 if two or more children)
- no rights to insurance proceeds or RRSP/RRIF if not beneficiary except in value on equalization or under the claw back provisions in a dependent’s relief claim under the *SLRA*

First Marriage – Why Do We Need a Will?

- Why a will?
- Effect of not having a will:
 - Inappropriate distribution of assets
 - Guardianship issues
 - Minors interest paid into Court, applications to Court for funds as needed, entitled at 18, no trust provisions
 - Inappropriate executors v. choice of executors
 - Estate Administration Tax (“probate fees”) which could have been avoided with proper planning
 - Income Tax which could have been avoided with proper planning
 - Peace of mind jeopardized
- “Do it yourself” wills & poas are not recommended!

First Marriage continued – Estate Administration Tax

Probate fee planning:

- Estate Administration Tax (“probate fees”) calculated at 0.5% on first \$50,000 and 1.5% on balance rounded up to nearest \$1,000
- No law requiring probate of a Will for the administration of assets – depends on the asset and institution holding the asset
- Only charged on assets governed by the Will
- Not charged on jointly held assets, assets payable to a named beneficiary, or assets governed by a Will which is not being submitted for probate

First Marriage – Estate Plans

- A 'will' vs. an 'estate plan'
- Estate plans include:
 - The will (or primary and secondary wills)
 - Power of Attorney for Property
 - Power of Attorney for Personal Care
 - Insurance trusts and RRSP/RRIF/TFSA/Pension beneficiary designations
 - Trust provisions for minors
 - Henson trusts; trusts for other dependants
 - Transfers of property (to joint tenancy, as inter vivos gifts, inter vivos trusts, alter ego or joint spousal trusts)

First Marriage – Mirror Wills

- ‘Mirror’ wills:
 - Wills which are essentially identical
 - One will for each spouse
 - Each spouse is named the initial executor and beneficiary in each other’s will
 - Alternate executors and beneficiaries are named
 - Custody provisions if both die
 - Alternate beneficiaries are the couple’s children
 - Money for children, grandchild, etc. to be held in trust until said child reaches a specified age(s)
 - Identical global disaster provision
 - Typical scenario for young couples/first marriages

First Marriage – Power of Attorney for Property

- Power of Attorney for Property
 - Donor grants authority to deal with his or her property
 - Property includes all assets—real property, bank accounts, cars, collectibles, investments, etc.
 - Effective right away v. springing
 - Valid if signed by donor while he/she is capable
 - If no POA exists, court application to be appointed— expensive, emotional and time consuming process

First Marriage – Power of Attorney for Personal Care

- Power of Attorney for Personal Care
 - An attorney for personal care makes personal care decisions on behalf of an incapable person [including: health care (including end of life decisions), nutrition, shelter (including move to nursing home), clothing, hygiene and safety)]
 - A POAPC may simply appoint the attorney or may also contain wishes/instructions regarding personal care wishes
 - A POAPC may only be used if the donor is incapable of making personal care decisions on their own
 - If an attorney is not named, under the *Health Care Consent Act, 1996*, the person who may act as the attorney is defined in a predetermined order that does not necessarily reflect the donor's preferences

First Marriage – Assets with Named Beneficiaries

- Naming beneficiaries for certain assets
 - Insurance policies
 - RRSPs
 - TFSAs
 - pensions
- Assets with named beneficiaries are not subject to probate fees
- On death, distribution of these assets is quick and efficient
- But, beware of income tax implications

First Marriage – Insurance Trusts

- Insurance Trusts
 - Often people wish to name their children as contingent beneficiaries on their insurance policies
 - If a minor child is named as a contingent beneficiary, insurer must pay the proceeds into court until the child turns 18
 - When using an insurance trust, a trustee is named as the contingent beneficiary to the insurance proceeds
 - The trustee receives the funds and holds them in trust in accordance with the trust direction (which usually mirrors the trust provisions in the will)
 - Prevents insurance proceeds from being paid out to court or young adults who are not ready to manage large sums of money
 - Save probate fees on insurance proceeds

First Marriage – Joint Ownership of Assets

- Real property can be held:
 - By an individual
 - As joint tenants
 - As tenants-in-common
- Assets such as bank accounts can be owned jointly with a right of survivorship
- Joint tenants enjoy the right of survivorship
- No probate fees payable on property transferred by survivorship
- Keep in mind joint tenancy means *joint ownership*
- Can have negative income tax and land transfer tax consequences, especially concerning assets held jointly by parents and adult children
- What happens to property on matrimonial breakdown?

Accumulation of Wealth & Growth of Business

Hugo and Roger: Shareholders' Agreement

1. Rules regarding the operation of the business
2. Obligations to contribute additional capital or loans
3. Shareholders' loans treatment
4. Restriction on transfer of shares
5. Employment duties
6. Provisions to cover voluntary sales; 3rd party offers

Accumulation of Wealth & Growth of Business

Hugo and Roger: Shareholders' Agreement Continued

7. Divorce mechanism: shot-gun, auction, sale of business
8. Mandatory buy-out provisions on disability, deemed disability, retirement, death
9. Non-competition covenants on sales
10. Valuation mechanism
11. Funding of mandatory buy-outs
12. Minimum: buy-sell agreement

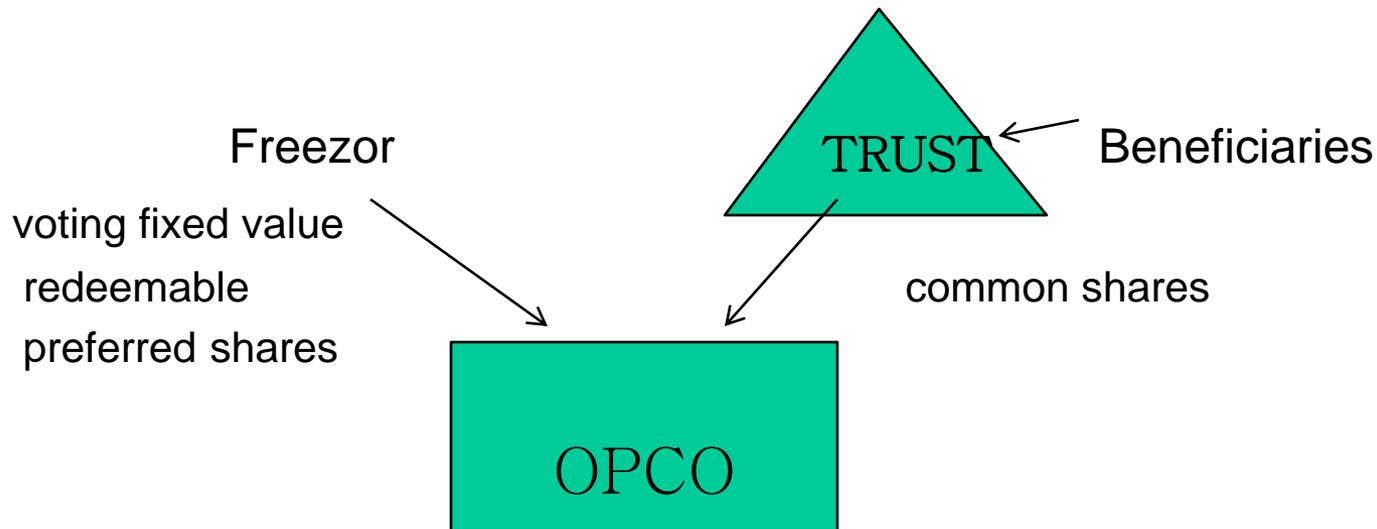
Accumulation of Wealth & Growth of Business Hugo's Estate Freeze at Age 54

- Common technique used to “freeze” the first generation owner’s tax liability and pass growth of business on to second generation
- Also used to freeze significant investment portfolios and pass on growth to second generation by interposing a holding company
- Permits income splitting and pre-tax funding of adult child’s expenses
- Multiplies the availability of the capital gains exemption on qualified small business corporation shares
- Can be done with or without an *inter vivos* trust

Accumulation of Wealth & Growth of Business

Hugo's Estate Freeze at Age 54

- Typically done using an 85(1) rollover, 86 reorganization or 51 share exchange for freeze shares followed by subscription for new common shares by adult children or family trust
- Post –freeze results:



Accumulation of Wealth & Growth of Business

Hugo's Estate Freeze at Age 54

Legal issues to consider:

1. Hugo must understand that gift is irrevocable
2. Ensuring control remains with Hugo – possibly super- voting preferred shares; but this is NOT unlimited
3. Consider *Family Law Act* implications of recipient child: proper documentation of gift, marriage contract [*McCain v. McCain, 2012 ONSC 7344 (CanLII)*; mid-marriage contract]
4. Consider how to get the shares back: share attributes, separate classes, shareholders' agreement
5. Shareholders' agreement among all shareholders to deal with:
 - (a) potential oppression issues by freezor
 - (b) potential conflict among the next generation
6. Spouse initiating the freeze may need to demonstrate that it is not improvident depletion of his property under the *FLA*

Accumulation of Wealth & Growth of Business: Inter Vivos Trust

- An inter vivos trust may be used in conjunction with an estate freeze, or separately
- Typically – completely discretionary trust
- The Non-tax reasons for establishing a trust:
 - 1) To transfer assets to beneficiaries who are minors, disabled or incapable of managing assets;
 - 2) To transfer assets while retaining control either by being a trustee or choosing the trustees;
 - 3) To protect assets from creditors;

Accumulation of Wealth & Growth of Business: Inter Vivos Trust

- 4) To shelter assets from spousal claims under the *FLA* or from dependants' relief claims under the *Succession Law Reform Act* (“*SLRA*”);
- 5) To provide for disabled beneficiaries without jeopardizing their government benefits;
- 6) To maintain confidentiality;
- 7) To centralize property and continuity of management of the property; and
- 8) To provide for the succession of assets in a private document, which is not subject to the probate process of the courts.

Accumulation of Wealth & Growth of Business: Inter Vivos Trust

- Summary of guidelines to avoid attribution rules and other tax traps:
 - 1) Settlor should be 3rd party (preferably non-resident of Canada) who settles trust
 - 2) Settled amount should not generate income or capital – coin
 - 3) Settled amount should never be liquidated or used to subscribe for income producing assets
 - 4) Funds used to acquire income or capital growth property should be borrowed from third party financial institution and not guaranteed by any person to whom the beneficiary is a “designated person” as defined in the *ITA*

Accumulation of Wealth & Growth of Business: Inter Vivos Trust

5) Trust should be irrevocable

6) Property should never revert to the settlor/contributor other than by operation of law on the failure of the trust

7) Settlor/contributor should not act as a trustee who has sole or veto power – should be one of three, decisions by majority; no decisions if vacancy until 3rd appointed

8) Settlor/contributor should not have sole power to appoint, remove or replace any trustee

Accumulation of Wealth & Growth of Business: Inter Vivos Trust Continued

Legal Issues to consider:

1. Hugo must understand that assets of the trust are not his ever
 - consider having Hugo and his spouse (beware!) as discretionary income and / or capital beneficiaries
2. Discretionary trust
 - ensure that even-handed rule is not applicable
3. Trustees
 - consider removal and replacement of trustees – Hugo is not a settlor or contributor so avoid attribution rules
4. Matrimonial issues
 - consider mandatory deemed resignation of Penny as trustee on separation or divorce
 - consider requirement for marriage contract before distributions made to beneficiaries

Accumulation of Wealth & Growth of Business: Inter Vivos Trust Continued

5. Power to add additional beneficiaries
 - keep “child” category broad – child of freezor

6. Avoiding conflict among beneficiaries
 - consider condition in trust that requires beneficiaries to enter into an agreement within a set period of time prior to distribution of shares failing which, trustees enter shareholders’ agreement or buy-sell prior to distribution to bind shares

7. Formal accounts
 - consider having informal accounts bind beneficiaries

Accumulation of Wealth & Growth of Business: Multiple Wills

Hugo and Penny's up-dated Estate Plan:

- Comprehensive asset listing
- Consider with client's other advisors:
 - income tax issues on first death
 - income tax issues on second death
 - cash flow needs on first death
 - funding options: insurance on both, joint-last-to-die

Accumulation of Wealth & Growth of Business: Multiple Wills

Hugo and Penny's up-dated Estate Plan:

- Reduce probate fees by segregating assets into two pools – Primary and Secondary Wills
- Secondary Will – all assets which do not require probate: personal property, real estate in registry system, shares in private companies, interests in private trusts, partnerships, debts owing by private companies, private trusts, partnerships
- Eliminate custody provisions, youngest is 16
- Adding children as alternate executors, attorneys for property and personal care
- Maintain the Henson Trust, consider trustees; revisit children's trusts
- Contingent beneficiary on insurance – insurance trust
- Joint ownership of assets
- Facilitate estate admin: add Penny as signing officer

Accumulation of Wealth & Growth of Business: Spousal Testamentary Trust

Usually driven by the tax savings of creating a second taxpayer who pays at the graduated rates

Tax benefits may be outweighed by:

- cost of estate administration – legal fees, accounting fees, executor's fees of maintaining a spousal trust for many years
- costs of 3rd party professional trustee
- unhappy surviving spouse who must justify encroachment to children or 3rd party
- potential for surviving spouse to choose *FLA* election instead of life estate
- generally: not recommended in a first marriage unless the estate is very, very large and carve out bequests of home, vacation properties, personal effects, and possibly significant legacy

Accumulation of Wealth & Growth of Business: Testamentary Trusts for Children

Tax savings of creating testamentary trusts for children, additional taxpayer at graduated rates & income splitting, may be outweighed by:

- cost of estate administration – legal fees, accounting fees, executor's fees of maintaining testamentary trust for many years
- costs of 3rd party professional trustee
- fiduciary obligations of the trustees to consider all beneficiaries
- unhappy children who must justify encroachment to 3rd party
- generally: recommend a flexible approach to the trust
 - optional trust at outset
 - initial encroachment and complete encroachment rights
 - child as trustee
 - discretionary trust with removal of even-hand requirement

Hugo and Penny's Separation and Divorce

- separation does not revoke a Will or gifts made to the spouse
- divorce does not revoke a Will but S.17(2) of the *SLRA* provides that a gift to former spouse made in a will is void and the appointment of the spouse as executor is revoked - NOTE: it is dangerous to rely on this because it may not apply to Wills that aren't governed by Ontario law
- Neither separation or divorce revokes the beneficiary named on an RRSP/RRIF; pension; TFSA or life insurance
- Neither revokes a Power of Attorney or Power of Attorney for Personal Care
- if no document exists, under the *Health Care Consent Act*, a spouse cannot make health care decisions for the other spouse once separated
- Pro/con of severing joint tenancy

Hansen Estate v. Hansen – course of dealing may be sufficient

Hugo (age 60) and Penny's Separation and Divorce - *FLA* Issues

- if the separated spouse started an equalization claim before the death of the other spouse, it can be continued against the estate
- if did not start an equalization claim, the separated spouse can elect to take under the will or intestacy rights or for his/her equalization payment
- valuation date will be the first of separation, divorce or death
- limitation period will be the shorter of six years after the date of separation or six months after the first spouse's death
- **THE s. 7(2) TRAP:** In the case of the estate of the **deceased spouse**, if no equalization claim was commenced under s.5(1) of *FLA* before death, it is no longer available to the estate against the surviving spouse and a s.5(2) claim is also not available to the estate against the surviving spouse

Hugo and Penny's Separation and Divorce – STOP-GAP ESTATE PLANNING DOCUMENTS

- New Wills removing Penny as executor & beneficiary, trusted CA friend as executor
- Ensure *FLA* & support obligations will be met and no more
- Change Attorneys for Property and Personal Care – CA friend
- Consider proper use of life insurance as security for the payment of support for spouse and children – using a trust and limiting the payments to the obligation to avoid windfall

Often overlooked:

- Taxability and deductibility of spousal support on death
- What about spouse involved in the business, director/officer of corporation, trustee & beneficiary of family trust?

Second Marriage (Hugo is 60) – Blended Family Considerations

- Marriage Contract – starting position what’s mine is mine, what’s yours is yours, no election on separation or death, release of all rights and claims – sunset clause
 - NOTE: *SLRA* dependant’s relief claim - where “adequate” provision for support has not been made, s.63(4) provides that an order for support may be made despite any agreement or waiver to the contrary
- 1) Immediately: republish existing Wills in contemplation of marriage
 - 2) Birth of Leonard:
 - amendment to family trust to add him and his issue as beneficiaries
 - amend Wills to cover custody of Leonard
 - add trust for Leonard, Bernadette as trustee

Second Marriage – Blended Family Considerations

Marriage matures and crystallizes (**now Hugo is 67**), up-date Estate Plan to provide:

- RRSP to Bernadette, conditional on her rolling into her plan
- personal effects to Bernadette
- matrimonial home to Bernadette; perhaps spousal trust or outright gift
- perhaps spousal trust in part of the residue – allocate assets which have capital gains (shares in building corps)

Estate Plan re; kids:

- 1) Education & maintenance trust for Leonard; RESP
- 2) The Business (preferred shares in Opco):
 - to Amy, valuation and debit against residue
 - valuation and option to purchase at FMV
 - estate causes Opco to redeem, if funds available in Opco
 - may be mandatory buy-out in shareholders' agreement

Second Marriage – Blended Family Considerations

- 3) Tie into potential distribution under family trust
- 4) Cottage to Howard – valuation and debit against residue or option to purchase at FMV
- 5) Consider how to cover off capital gains tax on 2 & 4
- 6) Legacies in trust for grandchildren
- 7) Residue – portion in Henson Trust for Sheldon
 - Trustees to be Amy & Howard? 3rd party too?
 - equal portion of residue to Amy, Howard & Leonard
 - testamentary trusts – optional and mandatory
- 8) Consider providing favourable lease terms for building in which Opco operates – for fixed initial term
- 9) Require or impose Shareholders' agreement in building corporations
- 10) Who should the executors be, Bernadette, Amy & Howard?
 - trusted CA, 3rd party professional trustee? Mix?
 - majority rule? Bernadette to be part of majority?

Second Marriage – Blended Family Considerations

Other Documents:

- 1) Power of attorney for property – Bernadette, Amy & Howard?
-trusted CA, 3rd party professional trustee? Mix?
- 2) Power of attorney for personal care – Bernadette alone? With Amy & Howard?
- 3) Insurance trust – who should the trustees be?

Estate Planning Outside of the Wills:

Probate reduction:

- 1) Consider whether a joint spousal trust would be useful - perhaps for the matrimonial home
- 2) If considering outright gifts to Bernadette, consider transferring to joint ownership as joint tenants
- 3) Transfer of registered title to certain assets to bare trustee corporation
- 4) Consider gift or transfer into joint ownership of cottage with Howard (deal with resulting trust issue)

The Family Cottage

- Cottage property carries with it unique concerns
- From the perspective of an estates lawyer, selling prior to death is always a good option, but it is not always desirable for the family who is emotionally attached to their second home
- Communication is key
 - Family meeting before drafting the will or any agreement
 - Be realistic (time, money, desire)
 - Agree in writing

The Family Cottage

- Inter vivos transfer
 - Capital gains
 - Relinquishing control
 - Matrimonial issues (i.e. designation of principal residence as matrimonial home so as to protect the cottage from an *FLA* claim)
 - Co-ownership agreement
 - By consensus, or if no consensus can be reached, by way of a default agreement
 - Cover issues such as: type of legal ownership (joint tenants, tenants in common), financial contributions, use of the cottage, what happens in the case of bankruptcy, divorce, death of any of the co-owners, termination of the agreement, payouts to departing owners, breach of agreement

The Family Cottage

- Outright gift in a will
 - Can beneficiaries afford the cost of upkeep? Do they all want the responsibility?
 - Co-ownership agreement
 - Capital gains
 - Designate as principal residence
 - Fund from other estate assets
 - Life insurance
 - By children from own resources
 - Matrimonial issues
 - What about the next generation?

The Family Cottage

- The Cottage as part of the residue of your estate
 - Option for a beneficiary to buy property at FMV
 - Relieves monetary issues but does not address sentimental meaning
 - May create resentment between siblings
 - Moral obligation but no legal obligation to keep the property ‘in the family’ after purchase is complete

Hugo Retires @ 70 – Business Succession

Options:

1. Sale in open market to third party
2. Internal sale to Management/employees
3. Gift/succession to family

Amy obvious answer for Hugo

- retirement may be covered in shareholders' agreement
- retirement compensation; consulting agreement
- mandatory redemption of preferred shares over time

Hugo Retires @ 70 – Business Succession

1. Family trust - common shares –
 - (a) wind up and distribute common shares to Amy alone
 - (b) prior to distribution, convert portion of common shares to fixed value, interest-bearing redeemable, retractable shares to be distributed to children not involved in business (and trusts for minor/Leonard); shareholders' agreement
2. Revisit the Wills - balance value of distribution out of family trust with distributions under the Wills to others
3. Are there other pools of money? Insurance?

The Death of Hugo

Professional Advisors



The Death of Hugo

- Accountant/tax advisor for all tax returns
- Registration of Estate an employer with CRA
- Estate accounting—a different beast
 - Summary of original assets & liabilities
 - Capital receipts, cross-referenced
 - Capital disbursements, cross-referenced
 - Income receipts, cross-referenced
 - Income disbursements, cross-referenced
 - Statement of investments
 - Statement of compensation
 - Statement of assets & liabilities at end of period, cross-ref
- Post mortem tax planning – implement your tax plan
- Financial/tax/estate planning for Bernadette

Next steps

- Wealthy young Bernadette plans to marry the pool boy
- We start the whole process over again!

CONCLUSION

Call us –your friendly estate & trusts lawyers.
We'd love to work with you!



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