

# COMMENT

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## Joint and Several Liability

Where parties have joint and several liability, each party can be held fully responsible for such liability. This can have serious tax consequences when the special tax collection powers of the Canada Revenue Agency (CRA) are invoked.

In a recent tax assessment, CRA sought to collect from the beneficiary of a registered retirement income fund (RRIF) the income tax liability created by the deemed disposition of the RRIF that was owed by the estate. The beneficiary appealed to the Tax Court of Canada. While the taxpayer (i.e., the beneficiary) appeared to have partially won the case, it was not in a monetary sense. The court agreed that the CRA could not collect from the beneficiary under the circumstances in the specific case at hand, but only because the quantum of the tax liability was not yet determinable. However, it went on to say that the CRA would be well within its powers to collect from a beneficiary even if the estate had some funds available just so long as the CRA assessed the estate first.

The Income Tax Act sets out the CRA's collection powers. Where money from a registered retirement savings plan (RRSP) or RRIF flows to a named beneficiary upon the death of the annuitant, the CRA is given the powers to collect the associated income taxes owing from either the estate or the beneficiary. The reason for such a provision is that the CRA may lose access to funds that triggered the income

tax liability, for example, in a case where there are not enough assets in the estate to pay the outstanding liability. The amount of tax that can be assessed from the beneficiary is equal to the additional marginal tax liability created in the estate because of the deemed receipt of the RRSP or RRIF proceeds in the hands of the deceased. (Where the beneficiary does not receive the full RRIF proceeds, then the estate's marginal liability can be collected from the beneficiaries based on the proportion of the plan proceeds received by each of them.)

In the case in question, it was not clear the terminal returns had been filed and, as a result, the CRA did not appear to have appropriately calculated the additional marginal liability created by the RRIF proceeds in the estate. Consequently, the joint and several liability of the beneficiary could not be quantified until the CRA had assessed the estate.

From a planning point of view, the income tax liability associated with RRSPs and RRIFs should be addressed in advance in some conscious fashion. If the RRSP or RRIF is left to one heir and the estate residue to another heir, an unintended and potentially devastating imbalance could occur if the income tax liability is taken from the "wrong" party.

I/R 2121.00; 5401.00

## The Other Side of the Buy-Sell Arrangement

A lot has been written about the fundamental importance of buy-sell agreements for shareholders and many business owners have put life-insured funded arrangements in place. This is an important component of risk management as it protects the financial positions of both the deceased shareholder and the surviving shareholder(s).

By undertaking these initiatives, the deceased's estate has a known market for the shares and is then able to convert the shares of the business into cash that can subsequently be reinvested based on the family's ongoing needs, wishes and risk tolerance.

The ongoing shareholder is afforded the opportunity to continue the business without the burden of a passive shareholder. Creditors, employees, customers and suppliers of the company gain comfort in the knowledge that the surviving shareholder will not be burdened with financing a buy-out that could otherwise distract from an ongoing focus on the affairs of the business.

However, what is often lacking in the buy-sell planning process is a thorough review of the deceased shareholder's estate. Such a review should entail an analysis of the financial aspects of the estate and the sufficiency of the surviving family's sources of ongoing income.

The review of the estate could look something as follows:

	Liquid assets of the estate
Plus:	Life insurance proceeds payable to the estate
Less:	Debt repayments
	Income taxes
	Last expenses of the deceased
	Expenses of administering and settling the estate
	Bequests
Subtotal:	Net liquid position of the estate
Plus:	Other assets of the estate
Equals:	Residue of the estate

In general, the income taxes triggered on death will be as a result of the sale or redemption of shares pursuant to the buy-sell arrangement and the type and amount of taxes will depend on the specific structure employed in the shareholders' agreement. Total income taxes payable will also depend on whether the agreement permitted the shares to roll over to a surviving spouse (generally through a "put-call" type of arrangement) and any other tax deferral elections completed by the estate.

The analysis of the financial position of the ongoing family could look something as follows:

	Residue of the estate (including proceeds of the buy-sell agreement)
Add:	Life insurance, RRSPs and RRIFs, and pensions payable to the surviving spouse/family as designated beneficiary
	Jointly owned assets transferred to the spouse/family by right of survivorship
Subtotal:	Financial assets provided by the estate/deceased
Add:	Financial assets of the surviving spouse/family
Equals:	Total assets available

The total assets available need to be broken down in order to determine which assets can be used immediately to produce income, which cannot or should not be used and which can or should be deferred for future use.

- 1) Investable or invested assets that can produce income
- 2) Deferred income assets (i.e., RRSP, RPP, etc.) — retain, if possible, for future use
- 3) Lifestyle assets (i.e., home, cars, etc.) — do not produce income (unless an asset, such as a second car, is sold)

The surviving family's ongoing income position would then be comprised of investment income on their investable assets, earned income from employment and government benefits (like CPP survivor benefits) less income taxes. The combination of these amounts would then be

assessed to determine whether the survivors' ongoing income would be adequate for their ongoing needs.

and it is vitally important to complete the process by examining the shareholder's own personal estate planning needs.

While the buy-sell arrangement is an important step, the analysis must continue into the estate of each shareholder. A funded buy-sell arrangement is a great start, but is only the beginning of an estate plan for each shareholder,

I/R 1450.00

## Capital Gains Deduction

There are a tremendous number of criteria that must be met in order for an individual to qualify for the qualified small business or family farm capital gains deduction, and the Federal Court of Appeal just added another.

Tax Act that states that when there is a change in control of the corporation, the change is deemed to have occurred at the beginning of the day. The application of this deeming provision meant that, at the time of disposition, the company was not a Canadian-controlled private corporation (as it had been at the beginning of the day), but instead was a publicly controlled Canadian corporation and hence no longer qualified for the exemption.

In order to qualify for the capital gains deduction for personally owned shares in a private company, the shares disposed of must be "qualified small business corporation shares" at the time of disposition. In order to meet this definition, all three of the following criteria must be met:

While it is possible to elect out of the application of the above-noted deeming provision, it requires the co-operation of both parties or a specific mention in the sale agreement. The buyer may not be co-operative on this point because it will affect some post-sale planning opportunities by creating an additional deemed year-end.

- 1) at the time of disposition, the shares must be shares of a small business corporation. A small business corporation is defined as a Canadian-controlled private corporation where all or substantially all of the fair market value of the assets are principally used in an active business carried on in Canada;
- 2) throughout the 24 months immediately preceding the disposition, the shares were not owned by anyone other than the individual or a person related to the individual; and
- 3) throughout the same previous 24 months, at least 50 per cent of the fair market value of the assets was principally used in an active business carried on in Canada.

Tax planning is an ever-changing field and what may seem obvious should always be double-checked because there are many nuances in the rules.

I/R 7401.011

The Federal Court of Appeal case, *La Survivance v. The Queen*, involved an individual who sold his company to a public corporation. Specifically, it considered a deeming provision contained in subsection 256(9) of the Income

## A Long Weekend To Remember

The summer long weekends are a lot of fun for a lot of Canadians, but for a few families, they can also bring disaster. Accidents happen and by definition are unexpected.

Estate planning is often carried out anticipating that individuals will live to life expectancy. And many people put off any planning because it is not viewed as urgent among the many other priorities in today's world of multi-tasking. But accidents can turn the spotlight on gaps in an individual's plans and the skills of the planners engaged by the individual to ensure that up-to-date plans are in place. A planner should finish every engagement with the knowledge that he or she would be proud of the plans in place should an accident befall the client at any time.

Estate planning should address some or all of the following questions:

Does the current will reflect the wishes of the testator? Are bequests in place for any promises made to others? Are the bequests funded or will they reduce the residue of the estate? If a specific asset has been bequeathed, does it still exist? Are the chosen executors willing to take the role and capable of carrying out their responsibilities?

Have guardians been named in the will to take care of the children should both parents be involved in an accident? Are the guardians willing to take the role? Will anyone else in the family challenge the named guardians? The individuals acting as guardians will have to be approved by the courts, but the courts will typically take direction recognizing the wishes of the parents regarding the named guardians.

Has the surviving family's ongoing financial security been considered? The most important financial consideration for the surviving family will be income. There are only three sources of income: earned income or pensions from employment, income from investments and income from government sources. Investment income can be created with the use of life insurance and the quantum is usually more important than the type.

Have the liquidity needs of the estate been considered? Income taxes, last expenses (such as funeral costs) and debts should all be taken into account. Having the mortgage insured at the bank may eliminate the mortgage upon a premature death, but a personally owned insurance policy could give the family the choice of keeping the funds and leaving the mortgage in place, depending on the facts and economic conditions at the time of death. Spousal rollover rules may help defer some taxes that would otherwise come due upon death, but if there is no spouse surviving or if both spouses die in the accident, income taxes could cause a significant drain on the estate's liquidity position.

Planning is the responsibility of the individual and the professionals he or she engages in the process. A planner should complete each engagement as if his or her plan will be reported in the local newspaper following an accident. While careful advanced planning cannot reduce the emotional impact of a sudden loss, it can reduce the financial implications and remove any compound effects of a sudden accident.

I/R 2500.00

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