



Planning for Your Stock Portfolio's Future

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Is your stock portfolio a significant part of your estate, something that you want to pass on to your children, friends, or favorite charities after you are gone? If that's the case, planning for the day when your portfolio changes hands can help that transition happen smoothly and maximize the value of your estate for your heirs.

If you are certain that your spouse (who can inherit your portfolio with the taxes being deferred) will outlive you and has the skills to manage the portfolio, then planning is relatively simple. It might begin and end with a visit to your lawyer to ensure your will reflects your current situation and your wishes.

But if you're not married, are uncertain your spouse will outlive you, have doubts about your spouse's ability to manage the portfolio, or plan to give your portfolio to your children, friends or favorite charity—then planning can bring real benefits to your estate.

One of the goals of all succession planning is tax reduction, or if that is not possible, tax deferral. The less tax your estate pays or the longer you can defer paying the tax, more wealth can go to your beneficiaries.

Like other privately held assets, including real estate and works of art, the Canada Revenue Agency considers your stock to have been disposed of at its fair market price on the day you die. If someone other than your spouse inherits your stock portfolio, the capital gains tax that the deemed disposition of your stocks incurs is payable.

The tax bill on a successful portfolio is significant. If, for example, \$300,000 of your portfolio is subject to capital gains tax, then your estate will face a tax bill close to \$70,000.

Imagine the chagrin of your heir if the stock in your portfolio has lost value in the time (up to a year) that can pass between the day of your death and the day when the estate is settled and stock is sold to pay the tax bill. Your estate could end up paying capital gains tax on unrealized gains.

There are a number of things you can do to maximize the wealth your heirs will receive from your estate, if your estate includes a substantial stock portfolio. Many of the

actions are small initiatives that will organize your assets and instructions in order to reduce the chance of litigation or complex investigations during the administration of your estate. These fall under the heading of good succession planning and will result in less money spent on legal and accounting fees in the administration of the estate—thus more wealth for your heirs.

Capital Gains Tax

There are some stock portfolio strategies that can lead to substantial, even dramatic, increases in the amount of your wealth that actually ends up in the hands of your heirs.

One of those strategies involves taking out a life insurance policy sufficient to pay the capital gains tax due on the deemed disposition of your stock portfolio at your death. The proceeds of a life insurance policy are not taxable. When your estate is settled, the capital gains tax is paid in non-taxable dollars, leaving your stock portfolio value untouched.

This strategy is particularly appealing for a person whose heirs are likely to regard the stock portfolio as an asset to be maintained and managed, rather than cashed in. It allows the heirs to take over the full portfolio without having to liquidate any of it to pay tax that is due.

People who intend to give some of their estate to a favorite charity can arrange the succession of their stock portfolio in a way that leads to tax savings. Instead of leaving cash to your favorite charity, leave part (or all) of your stocks.

This has tax advantages. In order to encourage charitable donations, the tax department halves the capital gains tax on Canadian securities donated to registered charities. That means substantially more of your estate goes to your intended beneficiary. For example, if a portfolio owner sold securities with a gain of \$1 million and donated the proceeds to charity, the capital gains tax would be approximately \$230,000. If the owner donates the portfolio itself to the charity, the tax bill would be in the range of \$165,000. And, your estate still gets the full donation deduction.

Other Succession Planning Issues

Even if your situation is less dramatic than the two examples outlined above, there are a number of things you should consider doing to ensure that your estate is in good order and your heirs get maximum value from it.

The first thing to do is choose an advisor. Succession planning is not something you can do on your own. You might start with your lawyer, your accountant, your financial advisor or a succession planner, but you need a professional who can bring an outside point of view to the process.

Getting the financial records of all your assets in good order is vital.

Unlike corporations, individuals do not normally have regular financial statements. If you have been making investments of various kinds over a number of years, chances are good that you have a variety of assets and obligations. Without realizing it, your left hand may have done things that your right hand doesn't know about. This can cause difficulties. You need a comprehensive overview of your assets to ensure that your succession planning acknowledges all of them.

Take a particularly close look at the tax status of your investments. Is your stock portfolio in a gain position? Is real estate in a gain position? Has investment property been depreciated for tax purposes, requiring you to add previous deductions back to your income when you dispose of the property?

Should you be considering life insurance to cover the anticipated tax? Should the insurance have an enhancement rider to cover future growth of the value of the assets? Are you in a situation in which it's advantageous to freeze the estate by incorporating?

If you are married and over age 65, you could consider moving your assets to an alter ego trust or a joint spousal trust to avoid paying probate fees on these assets.

You may also want to consider a dual will strategy to reduce probate taxes. The first will would deal with any interest you may have in a private corporation, partnership or personal property, thus avoiding probate on these assets. The second will would deal with all your other assets and probate fees payable on these assets. (Note: this strategy works in Ontario—it may not work in all other jurisdictions.)

While you are doing this, you will also want to ensure that all financial records are in good shape to make it easy for your executor, spouse and/or children to administer your estate.

Other important issues in estate planning revolve around your personal situation and the circumstances of your heirs. Have you been married more than once? Do you have children by more than one partner? Do you have disabled children? Do you have financially dependant family members? Do some of your heirs expect to receive cash while others

are already managing assets they expect to inherit and continue to make their living from?

Dealing successfully with these questions is the trickiest part of successful estate planning. Dealing with a stock portfolio can be a touchy issue when the owner wishes to pass the stock portfolio on to the children while at the same time ensuring that the stock portfolio provides support for the surviving spouse.

In some cases, especially when there is concern over the ability of the surviving spouse to manage the portfolio, a spousal trust is a possible answer. The trustee may distribute income and possibly encroach on the capital to ensure the surviving spouse is adequately provided for. On the death of the spouse, whatever remains passes to the children.

Spousal trusts, however, should be approached with caution, as the surviving spouse may resent them and/or consider it inadequate and/or commence litigation. Life insurance is sometimes a better solution with the proceeds from the insurance taking care of the spouse's needs, and transferring the portfolio directly to the children.

There are a lot of traps and pitfalls, both financial and emotional, in succession planning, whether it is for an estate made up primarily of a stock portfolio or one with a wide variety of assets. Careful planning, with the assistance of one or more professionals working together collaboratively, can help you get through the process. Your heirs will be happier and you will have the satisfaction of knowing that more of the wealth you created will stay with the people you want to own it.

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