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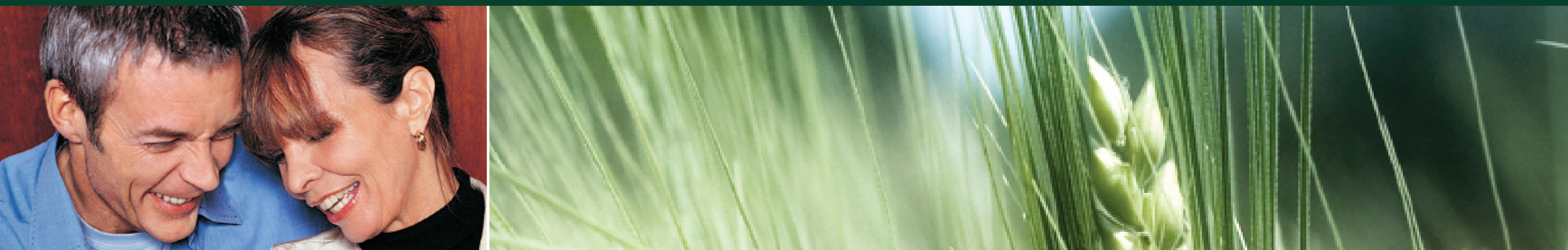

Inheritance strategies – Planning tips for receiving wealth

When a loved one passes away and leaves an inheritance to you, you may be filled with a range of emotions extending from intense grief to relief that some of the financial pressures you face are about to be lifted. Those mixed emotions can become even more confusing when complex wealth transfer rules come into play. To help you get through what can be a very difficult time, we've identified some planning tips you should consider if you find yourself receiving wealth.

HONOUR THE INTENTIONS OF YOUR BENEFACTOR

Sometimes a will specifically leaves assets to the deceased person's child – not jointly to the child and his or her spouse. This is a way to try and make sure that a bequest is not subject to "equalization" if a marriage breaks down. However, the deceased's intention can be frustrated by a son or daughter who invests the inheritance in the matrimonial home or other family assets that are not excluded from equalization claims. The co-mingling of inherited funds with other assets, so the inheritance can no longer be identified or traced, may also subject the money to equalization.

Children can honour their parents' intentions, and protect themselves in the event of a marriage breakdown, by making sure the inheritance remains separate from family assets, including the matrimonial home. Note that the legislation regarding property division upon marriage breakdown is specific to each province, so you should seek the advice of a legal expert when considering these issues.

PAY OFF NON-DEDUCTIBLE DEBT FIRST

We are a credit society and often depend on loans to get the things we want. However, it's important to recognize that there is good debt and bad debt. Good debt has tax-deductible interest payments and includes most investment loans[1]. Bad debt does not allow you to deduct interest payments – for example, most credit card balances.

[1]Consult with your financial advisor or tax professional to review the application of the interest deductibility rule for your specific situation.

If you decide to use inherited money to lower your debt load, the best strategy is to eliminate bad debt first. After all your non-deductible debt has been paid off, you may consider paying off deductible debt, making an RRSP contribution (assuming that you have RRSP contribution room available), or using the funds for another purpose. This type of simple tax planning can provide significant tax savings.

PREVENT FAMILY DISPUTES WITH EARLY COMMUNICATION

Unfortunately, many people focus exclusively on minimizing taxes when they are developing an estate plan and forget or overlook the value of preventing family disputes before they start. Too often, the courts are used to settle estate disagreements. These lawsuits can be vicious, tearing families apart and depleting the value of the estate.

It's a mistake to assume that heirs will understand and respect the wishes of a will especially when the manner in which the estate is divided comes as a complete surprise. Estates with unequal divisions are particularly susceptible to disagreements and litigation. Early communication is the solution, and children should be proactive and encourage their parents to both explain the reasons for their decisions to everyone involved and properly document their intentions. Discussing inheritance arrangements well in advance provides an opportunity to address complaints and answer questions in a much more comfortable and less costly environment than a court of law. It might be an uncomfortable topic of conversation, but talking things through now can reduce (though perhaps not eliminate) conflict after a parent passes away.

PROTECT YOUR DISABILITY BENEFITS

For people with disabilities, receiving an inheritance can be a mixed blessing. Expenses are often high and the money is very much needed and appreciated. However, an inheritance may disqualify a person with a disability from receiving disability benefits.

Each province administers a disability benefit program, and while they are not identical, many of them are very similar. Disability benefits are generally income and asset tested, so people with disabilities will only be entitled to benefits if their assets and/or income are below certain thresholds – and the thresholds are usually very low. Ontario, for example, allows a single individual without dependants to hold up to a maximum of $5,000 in assets and to earn up to $5,000 in income per year before it cuts off or reduces disability benefits.[2]

Receiving even a relatively small inheritance could, therefore, make a person with a disability ineligible for benefits. However, some provinces (Ontario and Manitoba, for example) allow an inheritance of up to $100,000 to be placed in a trust (or, in Ontario, in certain insurance investments such as segregated funds and insurance GICs) so the funds qualify as "exempt assets." Exempt assets are excluded from the asset test, so the individual's disability benefits can be preserved. These rules may not be effective in other provinces, so talk to your local disability benefit administrator before attempting to use this strategy.

CONFIRM THAT YOUR PARENTS HAVE A WILL

If you have ever received money from the estate of someone who died without a will, you have first-hand knowledge of the confusion that dying "intestate" can generate. The estates of people who die without a will are subject to provincial intestacy rules. These rules determine how assets are distributed, and this can lead to undesirable results. For example, assets may be transferred to an estranged spouse following a separation. Or they may be allocated to minor children, resulting in the funds being tied up until those children reach the age of majority. The bottom line is, if your parents – or you, for that matter – don't have a will, there's no better time than the present to create one.

[2] A number of assets are exempt from the Ontario $5,000 asset limit including but not limited to principal residence, one motor vehicle, a pre-paid funeral etc.

MAKE SURE YOUR OWN WILL IS UP TO DATE

Just as important as creating a will is periodically reviewing and updating it, especially after you experience significant changes such as receiving a large inheritance. Keep in mind that upon your death, the residual beneficiary of your will could be the sole beneficiary of your increased wealth – and this may not be your intention.

Consider the simplified example of "Mr. Jones," a single parent with two children, "Ashley" and "Brent." Mr. Jones' only assets are a home worth about $300,000 and an investment account also worth $300,000. His will states that the home goes to Ashley and the remainder of his estate, the "residual" goes to Brent. If Mr. Jones subsequently inherits an additional $200,000 and doesn't adjust his will, Brent will be entitled to the additional $200,000. This may be contrary to Mr. Jones' desire to split his assets evenly between his children. By updating his will, Mr. Jones can ensure that his will properly reflects his intentions and results in an equitable division of his assets.

By considering these planning tips you can avoid some of the common mistakes people make when receiving wealth, and ensure that your inheritance is used effectively – just as your benefactor would want it to be.

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