Tax, Retirement & Estate Planning Services

INVESTMENT INSIGHT

Taking capital gains or losses now to avoid the costs to settle your estate later

The idea of triggering capital gains by selling assets that have grown in value is one investors typically don't welcome. It generates a tax bill and also reduces the amount of capital that can be used to attain additional investment growth.

Ideally, from a tax perspective, if you are considering a transfer to a different product or investment you want your existing portfolio to be in a low gain or a loss position. This means there would be little, if nothing, lost to taxes on the transfer.

Yet, under some scenarios, this strategy can make sense. Triggering a capital gains tax bill now in order to take advantage of the wealth transfer benefits of segregated fund contracts and/or insurance company issued Guaranteed Interest Contracts (GICs) could enhance the final value of your estate.

THE CASE

Client: Let's assume you are a 70-year-old business owner who wishes to pass on as much as possible to your beneficiaries.

Current Portfolio:

$1,000,000	Market Value
$750,000	Adjusted Cost Base (ACB) – for tax purposes
$250,000	Capital Gain

THE PROPOSAL

Your advisor recommends you sell your entire portfolio today and invest in segregated fund contracts and/or insurance company issued GICs. Where a beneficiary other than your estate is named, this strategy allows your investments to avoid legal, estate administration and probate fees while facilitating a private[1] and fast transfer of wealth to your beneficiaries.

[1] In Saskatchewan the advantage of preserving a client's confidentiality does not apply as jointly held property and insurance policies with a named beneficiary are identified on the application for probate despite the fact that these assets do not flow through the estate and are not subject to probate fees.

THE ISSUE

If your portfolio is in a loss position, triggering that loss can provide immediate tax savings in addition to the advantages of bypassing your estate later. However, selling your entire portfolio may mean having to pay substantial capital gains tax today. The following discusses this scenario in more detail.

The $56,250 tax bill is not the real concern here as it will have to be paid eventually. **Your true concern is the cost of pre-paying this tax, that is the opportunity cost of the loss of potential growth on the $56,250 as outlined below.**

Capital Gain	$250,000
50% Income Inclusion	$125,000
Tax payable at 45%[2]	$56,250

$56,250 @ 6% growth for 10 years	$100,735
ACB	$56,250
(a) Capital Gain	$44,485
50% Income Inclusion	$22,243
(b) Taxes @ 45%	$10,009
(a–b) Net opportunity cost	$34,476

$34,476 is a substantial opportunity cost, but there are cost savings a segregated fund contract or insurance GIC investment provides at death over a portfolio of stocks or other investments. For a true comparison, you have to factor in the additional costs for the transfer of wealth from your estate if you kept your current portfolio.

[2] For illustration purposes only. Actual tax rate may vary.

The following cost projections are conservative, although the actual costs can vary based on your individual situation.

Account market value today	$1,000,000
Value in 10 years @ 6% growth	$1,790,848

Less: probate fee of 1.4%	$25,072
Less: legal, accounting & executor fees[3] combined for an additional 1.5%	$26,863
Total cost to transfer wealth from estate	**$51,935**

Cost to transfer wealth from estate	$51,935
Less: net opportunity cost to switch	$34,476
Savings on switch	**$17,459**

Under these circumstances, you would leave $17,459 more to your beneficiaries by paying the tax on the capital gain now and switching to segregated fund contracts and/or insurance GICs.

BEYOND OPPORTUNITY COSTS

Segregated fund contracts can help limit your exposure to market risk through death, maturity and income guarantees. A segregated fund contract or insurance GIC can also offer the potential for creditor protection while you are alive if an irrevocable beneficiary or a beneficiary of the family class is named.[4] Where a beneficiary other than your estate is named, your assets will flow outside of your estate and will generally be protected from your estate's creditors. In addition, distribution of your assets directly to a named beneficiary is almost always faster than settling an estate, and because probate is avoided, your bequest will remain private.

You don't have to sell your entire portfolio at one time to take advantage of this strategy. You can establish a segregated fund contract or insurance GIC today, and move assets gradually into the account. You can choose those assets that trigger the smallest tax consequences and gradually liquidate investments when you and your advisor believe the timing is appropriate.

IS THIS THE RIGHT STRATEGY FOR YOU?

To assist you in answering this question, Manulife Investments has created an online calculator that will help you and your advisor determine whether this strategy will work for you. To begin, you'll need the current value of your portfolio, the adjusted cost base and your current marginal income tax rate. By having your advisor input these variables in to our online calculator, he or she can quickly assess if this is the right strategy for your situation.

[3] This illustration assumes probate fees of 1.4 per cent similar to British Columbia's probate rates. The tax rate and probate fees applicable to you may be different. Legal, accounting and executor fees will vary depending on the complexity of the estate and the professionals retained.

[4] In provinces other than Quebec, a family class beneficiary is the spouse, common-law partner, child, grandchild or parent of the annuitant. In Quebec, a family class beneficiary is a married or civil union spouse, descendants or ascendants of the owner.

For more information contact your advisor or visit manulife.ca/investments

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