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No Cash to Pay Estate Tax? The Ins and Outs of Deferring Payments

WESTWARD ADVISORS

WESTWARD'S VIEWPOINT

Navigating the complexities of calculating and paying estate tax obligations can be challenging for executors. A major challenge arises when there is insufficient cash to pay the estate tax.

To assist with this challenge, the *Income Tax Act* provides a mechanism for deferring the payment of estate taxes arising from deemed dispositions of capital property and certain other property.

Capital property includes **shares of private corporations** that can give rise to substantial estate tax with insufficient estate liquidity to pay the tax.

The estate can elect to pay the tax in up to ten equal annual instalments starting on or before the usual estate tax due date plus non-deductible interest compounded daily.

Executors must understand the conditions and timelines for estate tax deferral and make timely payments to avoid further increasing the ultimate estate tax cost with late payment penalties.

The problem can usually be avoided altogether by **planning ahead to provide sufficient liquidity for the estate.** The private corporation can usually acquire life insurance on the shareholder at a fraction of the cost of the tax itself. The executor and the beneficiaries will be forever grateful to the deceased shareholder for investing a portion of the inheritance in life insurance premiums to reduce estate taxes and simplify the wealth transfer process.

For more information, clients can contact their Account Manager or Wayne Stone at WayneS@westwardadvisors.com.

ESTATE TAX DEFERRAL RULES

- Estate taxes are due either (i) April 30th of the year following the year of death for deaths occurring before November, or (ii) six months after the date of death that occurs in November or December.[1]
- The executor may elect to defer payment of certain estate taxes including estate taxes arising from deemed dispositions of capital property in up to ten equal annual instalments commencing on or before the estate tax due date.[2]
- The executor must provide security acceptable to the CRA, including bank letters of guarantee, standby letters of credit or mortgages. Other forms of security are determined on a case by case basis.[3]
- Non-deductible interest at the prescribed interest rate *in effect at the time of the election (currently 8%)* is compounded daily and is payable annually with the annual instalment payment.[4]

ILLUSTRATIVE EXAMPLE

Suppose an estate owes **$8,000,000** in taxes arising from the deemed disposition of private company shares and elects to pay in **8 equal annual instalments**:

	Principal Payment (1/8th of $8,000,000)	Interest on Outstanding Balance	Total Payment
On or before estate tax due date	$1,000,000		$1,000,000
1st Anniversary of first payment	$1,000,000	Interest on $7,000,000 from due date	$1,000,000 + Interest
2nd Anniversary of first payment	$1,000,000	Interest on $6,000,000 from last anniversary	$1,000,000 + Interest
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7th Anniversary of first payment	$1,000,000	Interest on $1,000,000 from last anniversary	$1,000,000 + Interest

1 See definition of *"balance due date"* in ITA subsection 248(1).
2 See ITA subsection 159(5) for the estate tax deferral provision.
3 Ibid and see *"Acceptable forms of security"* in CRA IC98-1R8, *"Tax Collections Policies."*
4 See ITA subsections 159(7) and 248(11).