The Income Tax Bond

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Don, 65, and Marie, 63, are about to retire. They have accumulated about $500,000 in their RRSPs and own their home, free and clear. They want to leave as much as possible to their two children. Don and Marie realize that the value of their home should pass tax-free to their children and know their RSPs will be fully taxable at that time.

They don't have a problem while they are both alive or even if one of them dies. Thanks to some good estate planning advice, there won't be much, if any, of a tax grab on the first death as everything goes to the survivor. RRSPs and RRIFs can pass tax-free to the surviving spouse, thus postponing taxes until the second death. **The big tax bite will occur on the second death**. Other assets may be subject to taxes at that time, too.

Don and Marie have decided to take an income from their RRSPs in the form of a RRIF. An income of $2,500 per month, increasing by 1.5% each year to allow for inflation, will leave about $465,000 at their life expectancy. With the top income tax rate at almost 50% in most provinces, that leaves only about $116,250 each for their children after the Canada Revenue Agency (CRA) finishes running the money through the income tax filter. And this filter is virtually unavoidable.

There is **a better way to take care of this tax problem**, a unique type of joint life insurance policy called joint-and-last-to-die. It is more economical than usual because it doesn't pay out until the second death. This policy can be an even better deal if bought at younger ages in preparation for the inevitable income tax bite.

Think of it as an 'Income Tax Bond'. Here's how it works - Don and Marie buy a 'Bond' to pay off their estimated $235,000 tax bill. All they pay, however, is a very low interest service fee for this Bond, about 1.5% per year as they are non-smokers. When the second person dies, the Bond matures for the full amount and gets paid to their kids, tax-free, and no further interest payments are required. In other words, the **Bond matures at the exact time the money will be needed most to pay the taxman**.

By adjusting their RRIF income a little higher to make the $300 monthly interest payment, Don and Marie will leave a bit less in their RRIF at life expectancy, about $425,000. The Income Tax Bond matures on the second death, just in time to pay the tax bill. The full amount of the RRIF then goes to their kids, about $212,500 each instead of $116,250. If the Bond pays more than required to pay the taxman, their kids get to keep the difference, too.

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