

# **THE LOCKED-IN ESTATE TRUST - A RESPONSE TO CANADA'S COMING PENSION CRISIS**

## **Summary**

The Chambers of Commerce recognize the severity of the Pension Reform problem in Canada and in 2010 at their AGM adopted a policy titled "The Base Principals of Pension Reform". There looms a pension crisis for Canadians in the near future. The federal government will be unable to fund the pension requirements of the baby boomer retirees let alone the requirements of subsequent generations of retirees. A Locked-in Estate Trust (LIET) is one of the many required solutions that would allow for individuals to privately fund LEIT's with the money being held in trust for the future benefit of the named beneficiaries of the LEIT.

## **Statement of the problem**

Our federal and provincial finance ministers are seeking solutions to protect older Canadians from income shortfalls during their retirement years, but there are few solutions on the horizon. At the same time, many older Canadians, through hard work and extraordinary windfalls in the housing market, find they have accumulated a great deal of wealth, but ironically, have little cash flow to supplement their own retirement.

It is estimated that as much as \$1 trillion dollars footnote will pass to the next generation of Canadians through estate transfers. Acutely aware of the value of their estates, many older Canadians have concerns about the wisdom of passing on such large lump sum estates to children and grandchildren.

Creating a new financial instrument could provide seniors with income now from their valuable estates and at the same time allow them to utilize family wealth to ensure that their children and grandchildren are able to receive private pension income when they retire. This could be fashioned similar to the Charitable Remainder Trust which is widely used and promoted in the United States.

A Locked in Estate Trust ("LIET") would provide a creative solution to our specific demographic quandary where the size of the retired population will soon far out weigh the working population. It also has the potential to remove some of the well documented and anxiously anticipated strain on the government's ability to provide Old Age Security and Guaranteed Income Supplement funding to Canadian seniors as the baby boomer bulge exits the workforce. Furthermore, a LIET would provide an investment vehicle that could ensure financial independence for subsequent generations of Canadians.

In recognition of the importance of responsible federal fiscal policy, the federal tax revenue will actually be enhanced by this account on a deferral basis. Typically, contributions to the LIET will result in a deferral of capital gains tax of which only 50% of the gain is taxed, whereas the subsequent withdrawal can and will be taxed as 100% regular income at the current marginal tax rate resulting in incrementally larger revenue tax stream.

Furthermore, this account could be used for the generational transition of small business interests similar to a “Family Trust” with this inclusion of limiting access to the revenue and pension income by the beneficiary until the beneficiary is at age 55.

### **Details of the problem**

Large pools of wealth in private portfolios transferred to a LIET would have the potential to significantly reduce the drain on government pension resources. It could also represent significant tax savings to individuals who make a decision to move wealth into a LIET.

The LIET would work similar to already available trust vehicles (Charitable Remainder Trust) but with tax advantages to the donor or the settler, such as a non-refundable tax credit based on the amount transferred into the LIET. Funds inside the LIET would be allowed to accumulate tax free and be professionally managed and guided by a conservative investment strategy.

The donor would be permitted to access a percentage of the income generated by the LIET while they remain alive.

Named beneficiaries of the LIET would only be allowed to withdraw a legislated percentage of the capital and income of the LIET after age 55, similar to Locked in Retirement Accounts (LIRAs). This would ensure the long term viability of the LIET for future generations.

Because of the tax advantages, the decision to create a LIET would be made by the donor before death and would be an irrevocable decision or the LIET could be created as a Testamentary Estate Trust (After Death).

It is anticipated that the tax foregone (by the granting of a tax credit to the donor and by a deferral of a valuation of the donor’s estate) is far outweighed by the reduction of costs related to pension benefits over the long term and the reduction in the benefits payable under Old Age Security and other government programs such as income tested health care and Guaranteed Income Supplement.

### **THE CHAMBER RECOMMENDS**

That the Federal Government:

Introduce an amendment to the Income Tax Act creating the “Locked In Estate Trust” as a step toward solving the Pension Reform problem in Canada and allowing a mechanism for business and Canadians to offer a more stable financial future for generations to come

Submitted by the Kamloops Chamber of Commerce