

Advisory

PLANNING TO MINIMIZE ESTATE TAXES UNDER THE ESTATE ADMINISTRATION TAX ACT, 1998 (ONTARIO)

As you may be aware, major changes occurred in 1998 to Ontario's former probate fee system. In this Client Advisory, we present an overview of Ontario's legislation imposing an estate administration tax in the place of probate fees. We will then briefly discuss various planning techniques to minimize exposure to this tax.

ONTARIO ESTATE ADMINISTRATION TAX

Ontario Estate Administration Tax (formerly "probate fees") is paid in order to receive a court order, formerly called a "grant of letters probate", and under present Ontario court rules, a "certificate of appointment of estate trustee with a will". This court order certifies that the will of a deceased person is valid and also confirms that the person(s) named as executor(s) in the will of the deceased person has the legal authority to administer the estate. Although the foundation of an executor's legal authority is his or her appointment under the will, third parties, including financial institutions, normally require this judicial confirmation before they will act on the instructions of the executor with respect to the assets of a deceased person. Statutory protection is available to the financial institution if it relies on this court order. In addition, legislation requires this court order to transfer certain assets, including real estate registered under the *Land Titles Act*. Probate fees were introduced in Ontario in 1793, and were continued through various statutes until 1950, when higher fees were introduced by way of regulation as opposed to by a statute enacted by the Legislature. They were

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increased several times since then, but gained increased attention in 1992 when the fee rate was tripled, effectively transforming them into a hidden wealth tax.

With the 1992 increase, the fees increased to ½ of 1% based on the first \$50,000 of estate assets and 1½% on the balance, making these rates the highest of any jurisdiction in North America. As a result, it became increasingly important for individuals, particularly those with substantial assets, to implement planning to minimize exposure to these fees.

THE *RE EURIG* DECISION

In the 1998 decision of *Re Eurig*, the Supreme Court of Canada held that probate fees levied by Ontario are in fact a tax, not a fee. It also held that because they are a *direct* tax as opposed to an *indirect* tax, they fall under the taxing jurisdiction of the Province. However, in order to validly levy a tax, constitutional law requires that all provincial bills must originate in the Legislature by way of specific legislation for such purpose. Probate fees in Ontario had been increased since 1950 by regulation, as opposed to by a bill enacted by the Legislature, making it simple for the Province to quietly raise rates. The Supreme Court held this method of raising the fee level by regulation, for what was in fact a tax, to be unconstitutional.

THE ESTATE ADMINISTRATION TAX ACT (ONTARIO)

Unfortunately, the *Re Eurig* decision has proved to be a hollow victory. Once the Supreme Court let the genie out of the bottle by holding probate fees to be direct taxes open to the Province to levy, it effectively allowed the fees to be re-imposed through a bill in the Legislature. There also appears to be no way of putting the genie back in the bottle – Ontario, as well as the other provinces, have been granted judicial blessing to impose this form of tax, and in future are free to raise the rate of tax with impunity.

As a result of the court decision, the Province of Ontario moved quickly to introduce remedial legislation, the *Estate Administration Tax Act, 1998*, which came into force on December 18, 1998. The legislation enables the Province to impose what is termed an estate administration tax (“estate tax”) on estate assets and is retroactive to May 15, 1950. The amount of tax payable under the Act is the same as the amount of probate fees previously payable by regulation.

ESTATE TAX PLANNING – TECHNIQUES

Planning to minimize the impact of estate taxes, particularly in large estates, is of increasing importance. There is nothing to stop the Province from increasing the tax rate in future. Probate fees have proved to be extremely lucrative to the Province. They are also an extremely inexpensive tax to administer. Several other provinces have followed the Ontario lead, and have substantially increased their rates.

The following chart illustrates the amount of estate taxes payable with respect to estates of varying values:

<u>Size of Estate</u>	<u>Estate Taxes Payable</u>
\$750,000	\$10,750
\$2 million	\$29,500
\$5 million	\$74,500
\$10 million	\$149,500
\$15 million	\$224,500

Briefly outlined below are several important estate tax planning strategies.

TRANSFER OF ASSETS TO JOINT OWNERSHIP

If assets are held “jointly with right of survivorship”, on the death of the first joint owner, in general, they do not form part of his or her estate. The joint owners, during their mutual lifetimes, both have the use and enjoyment of the property. When the first joint owner dies, by operation of law, the surviving joint owner in the normal course automatically becomes the owner of all the property because of the way in which title is held. With married couples, title to homes, bank accounts, and other financial assets is often held this way.

While an obvious planning technique to minimize estate tax is to place assets in joint ownership with right of survivorship, this strategy only makes sense if the surviving joint owner is the intended beneficiary of the asset, and if the transferor is willing to give up partial control and ownership of the asset. In certain

circumstances, a proposed transfer will raise other legal issues, including under the *Family Law Act* (Ontario). As well, if the transfer is made to persons other than one's spouse or minor child, the presumption arises that the person to whom the transfer has been made holds on trust for the person who made the transfer and that a gift was not intended, unless the recipient can prove the contrary. Also, it is important to realize that a transfer of beneficial ownership will result in a disposition of property for income tax purposes, in certain cases triggering unrealized capital gains as well as raising other possible tax consequences.

It is essential to consider all of the legal and tax implications of a proposed transfer of assets to joint ownership to determine the advisability of this strategy.

DESIGNATIONS UNDER LIFE INSURANCE, RRSPs, and RRIFs

If an individual has life insurance, RRSPs, RRIFs, or other registered plans, it is often advisable to designate a named beneficiary to directly receive the policy or plan proceeds on death.

Under the Ontario *Insurance Act*, proceeds of a life insurance policy do not form part of the deceased's estate if there is a designated beneficiary of the policy, and instead, are directly payable to the designated beneficiary.

Present court policy for RRSPs and other registered plans provides that proceeds from such plans are not included in the value of the deceased's estate for the purpose of calculating estate taxes if there is a designated beneficiary.

Accordingly, estate taxes are not paid on the value of either insurance or plan proceeds if there is a designated beneficiary outside of the estate.

TRANSFERS TO A TRUST

Since the objective of estate tax planning is to remove assets from one's future estate, another strategy is to transfer assets to an inter vivos (or "living") trust established during one's lifetime. The terms of the trust are typically designed to permit the payment of income and capital to the person who has contributed the property to the trust (known as the "settlor" of the trust) during the settlor's lifetime and also provide for distribution of the trust assets on the settlor's death. The trust can act as a "will substitute" and its terms can mirror the scheme of distribution set out in the settlor's will.

On the death of the settlor, the assets in the trust are not subject to estate taxes because they do not form part of the settlor's estate. Instead, the assets are distributed in accordance with the terms of the trust. It is also possible to provide that the terms of the trust may be revoked by the settlor at any time and the trust assets returned to the settlor, thereby maximizing the settlor's control over the assets. A revocable trust will result in the income of the trust being taxed in the hands of the settlor.

A transfer of assets to an inter vivos trust as described above will generally constitute a disposition for income tax purposes, triggering the taxation of any accrued capital gains. For persons age 65 or older, however, two special trust vehicles, the "alter ego" trust and "joint partner" trust are now available under the *Income Tax Act* (Canada), to which assets may be transferred on a tax-deferred basis. Use of an inter vivos trust to minimize estate tax exposure may be appropriate if the settlor is under 65 and has significant assets with no accrued capital gains (such as cash or near cash assets, including GIC's), or a principal residence, where an exemption from capital gains may be available. If age 65 or older, consideration can be given to possible use of an alter ego trust or joint partner trust.

INTER VIVOS GIFTS

In certain cases, an individual may be prepared to gift assets outright to children or other family members. While the effect of a gift is to remove a particular asset from the individual's estate at death, total control and ownership of the asset is also relinquished and cannot be regained. This strategy might be appealing where one is certain that there is no need for a particular asset or the financial security it represents, or where death is imminent. Since there are significant income tax consequences attached to gifting assets, careful consideration must be given to who the recipient will be and to the type of asset being transferred. Gifting assets to an individual, other than a spouse, for example, will generally trigger capital gains tax to the donor of the gift. As a result, this strategy works best if the assets being gifted have no accrued capital gains. As well, there are specific rules under the *Income Tax Act* which may apply to deem income from the gifted assets to be taxable in the donor's hands based on the relationship of the recipient of the gift to the donor.

MULTIPLE WILLS

Another planning technique involves the use of "multiple wills". As part of this strategy, two wills are executed: a primary will and a secondary will. In the primary will, the person making the will deals with all of his or her assets other

than shares of private family corporations, loans or other amounts receivable from those corporations, and other assets for which a court grant of the will is generally not required, such as personal and household effects. These specific assets are dealt with in a secondary will, the value of which often far exceeds the assets dealt with under the primary will.

Upon the death of the person who made the will, the executor discloses the existence of both wills to the court, but application is made for a limited court order for only the primary will. Estate taxes are then payable only on the assets covered by the primary will. A 1998 Ontario court decision in *Re Granovsky Estate*, confirmed the validity of using multiple wills for this type of estate tax minimization.

A further and perhaps preferred strategy using multiple wills involves moving assets, for example, a holding company, to a low-probate fee jurisdiction. Multiple wills are then executed, one dealing only with the assets in the low-probate fee jurisdiction, such as shares of a holding company, and the second will dealing with all remaining assets. Alberta has been a popular choice as a low-probate fee jurisdiction because court fees to probate a will are capped at \$400, notwithstanding how large the estate may be. This planning strategy may result in estate taxes being substantially reduced, and may be combined with other estate tax minimization strategies outlined in this discussion.

SUMMARY

Planning to minimize estate taxes is, of course, simply one aspect of comprehensive estate planning. Estate tax planning may be particularly relevant if one's potential estate is significant. Planning to reduce exposure to estate taxes requires not only a careful assessment of the estate tax to be saved in comparison to the costs of implementing the strategy, but as well, consideration of all relevant legal and tax consequences.

The comments offered in this Client Advisory are meant to be general in nature and are not intended to provide legal advice on any individual situation. Before taking any action involving your individual situation, you should seek legal advice to ensure it is appropriate to your personal circumstances.