Challenging Estate Planning Issues

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Table of Contents

	Page
I. Tax Basics on Death	3
A. Taking Taxation Into Account in Estate Planning	4
B. Income and Capital Gains Taxes in the Year of Death	4
C. RRSPs/RRIFs, TFSAs and Pension	5
D. Exemptions, Rollovers and Credits	6
E. A Note About Shares or Interests in a Closely-Held Corporation	7
II. The Use of Trusts in a Will and Trust Tax Basics	8
A. Types of Testamentary Trusts	8
B. Changes to the Taxation of Testamentary Trusts	16
III. The Use of Multiple Wills to Avoid Probate Fees	19
A. Probate Generally	19
B. When Probate May Be Required	20
C. Dual Wills to Reduce Probate Fees	20
D. How it Works	21
E. Example of Probate Savings	23
IV. Assets Passing Outside the Estate	25
A. Life Insurance, Pensions and RRSPs/RRIFs/TFSAs	25
B. Jointly Held Assets	26
C. *Inter Vivos* Trusts	28
D. Bare Trusts	29
E. Gifts and Gifts Mortis Causa	29
F. More Complex Extra-Estate Planning	30
G. A Note About RESPs	30
V. Estate Planning Considerations for Foreign Assets	31
A. Cross-Border Canada-U.S. Considerations	31
B. Estate Planning Considerations for Clients with Connections to Other Jurisdictions (Not U.S. Specific)	42

I. TAX BASICS ON DEATH

The implications and planning options available to taxpayers is the subject of many texts and articles, and this paper is not intended to replace them. Suffice it to say that tax matters require special forethought and advice, and the best that can be hoped for when first gaining experience in estate planning is the ability to send clients for expert advice as and when needed. This paper attempts to provide only a very broad overview of the basic income tax regime in Canada upon an individual's death.

I note that generally speaking where "spouse" is referred to, for Canadian income tax purposes a common law partner is included in the definition of spouse. Also, for any planning for a Quebec-resident client, special advice should be obtained as Quebec has many special rules regarding to whom and how assets can pass on death and what are the income tax consequences of the passing of such assets.

There are no “death” taxes or succession duties imposed by the Federal Government or any of the Provinces of Canada on either a deceased’s estate or the beneficiaries of the estate. In some jurisdictions, such as the United States and the United Kingdom, there are death taxes. It is possible that these taxes would also be triggered by virtue of owning assets in those jurisdictions, as discussed above, or if the testator has an affiliation with them such as by citizenship or domicile. As well, if the testator has beneficiaries with affiliations with these or other jurisdictions which have death taxes, including a spouse, special planning for their inheritance may be desirable to minimize exposure to such taxes. Some planning techniques for testators with multijurisdictional

connections are explored elsewhere in this paper. Further exploration of these topics is outside the scope of this paper.

A. Taking Taxation Into Account in Estate Planning

It is important to take into account the different tax consequences of different types of property on a testator's death in their estate planning. The simplest and most frequent example of this is a testator designating one child the beneficiary of their RRSP and the other the beneficiary of the residue of their estate, which consists mainly of a principle residence. Unless the children both agree otherwise, the testator's estate will bear the burden of the tax on the value of the RRSP proceeds, and the child inheriting the residue of the estate may end up with far less value than the child inheriting the RRSP, contrary to the testator's intentions.

B. Income and Capital Gains Taxes in the Year of Death

A taxpayer's estate will pay tax on all income, received or deemed received, in their year of death. This will include capital gains tax on all the taxpayer's capital property which is deemed to be disposed of on the date of their death, which means that their estate will pay tax at their marginal tax rate on the includable gain, currently 50% of the total gain, on the value of such assets, being the difference in the taxpayer's adjusted cost base (value at acquisition plus any allowable expenses in maintaining the asset) and the fair market value of the property at their date of death.

It is important to note that capital property deemed to be disposed of at death will include a taxpayer's interest in a jointly-held property, even if such property passes by

right of survivorship to a person other than a beneficiary of the deceased's estate, unless an exemption or rollover applies.

Life insurance is generally not taxable in Canada, being considered to have no value to the deceased at their date of death.

C. RRSPs/RRIFs, TFSAs and Pensions

The full value of RRSPs and RRIFs are included as income in a deceased's taxpayer's year of death, and are not taxed in the hands of the beneficiary of the funds unless the estate has no money from which to pay the tax, which can result in significant tax on death unless the plans are designated or otherwise pass to a spouse, or in a more limited way a dependant minor or disabled child, of the testator. The rollover to a spouse can be accessed even if the plan is not designated to the spouse, but the spouse must participate in a joint designation and put the funds into their own RRSP/RRIF for the rollover to apply.

If the testator is not leaving the residue of their estate to their spouse but has designated them the beneficiary of their RRSP, which is often a planning technique for spouses in second marriages or who wish to ensure family assets pass to other relatives, this condition for the rollover is important. In such circumstances a conditional gift dependant on the spouse putting the funds into their own RRSP/RRIF should be considered to avoid the surviving spouse receiving the full value of the plan in cash and not placing the funds into their own RRSP/RRIF, thus forcing the deceased spouse's estate to pay income tax on the value of the plan.

TFSAs will pass tax-free to a beneficiary, but any income earned after the death of the account holder will be taxable, unless the account holder's spouse is named as the successor account holder of the deceased's TFSA (as opposed to the beneficiary of the account, which is a different designation), in which case the spouse can continue the tax-free accumulation of income in the account.

Pensions have their own rules which will vary depending on who inherits the proceeds and whether or not the beneficiary is a spouse or not, accepts a pension or lump sum payout, and rolls the assets into their own RRSP/RRIF or not. Usually the beneficiary will be taxed on the pension proceeds, but tax advice should be obtained if there is uncertainty.

D. Exemptions, Rollovers and Credits

The deemed disposition of a taxpayer's property is subject to certain exemptions and rollovers. For example, there is an exemption for a person's principal residence. There may also be certain lifetime capital gains exemption limits available to the testator on death, as well as rollovers for certain qualifying farm and business property.

Assets passing to a spouse or a qualifying spousal trust are subject to a rollover such that the capital gain is deferred until the spouse disposes of the property or dies. Care must be taken to ensure that nothing in the Will taints the spousal trust and that all necessary provisions are included. Generally speaking, the assets must vest in the trust within 36 months of the deceased spouse’s date of death, the spouse must be entitled to all of the net income of the trust during their lifetime, and only the spouse can

be entitled to any capital or benefit from the trust during their lifetime (although capital encroachment powers are not necessary). Accidental tainting can occur, for example, where a general power is given in the Will to loan funds from a trust to any party, and this power is not qualified in regards to the spousal trust.

Any donations made to a qualifying charitable organization should give rise to charitable donation tax credits which can be used to offset tax payable by the testator's estate in their year of death. Such credits are additionally valuable as there is no limit on the deduction such credits provide in a taxpayer's year of death, so that 100% of the taxpayer's income in their year of death may be offset by charitable donation tax credits, unlike other taxation years.

If an asset has lost value, a capital loss will be generated which can offset any capital gains. Other tax credits may have been carried forward by the deceased and be available to offset tax otherwise payable in their year of death. It is therefore important for the estate's tax advisor to consider whether to elect out of certain rollovers to be able to use credits and losses most effectively.

E. A Note About Shares or Interests in a Closely-Held Corporation

Tax, tax planning and post-mortem tax planning involving corporate assets is a complex subject beyond the scope of this paper, however one note should be made about closely-held corporate shares or interests. Where a testator owns shares or other interests in a private corporation, certain planning techniques may in some circumstances be implemented post-mortem to minimize the overall tax burden of these

assets on their estate, but some of these techniques require steps to be taken by the corporation and/or the executors within the first year after the testator's death, and cannot be implemented thereafter. It is therefore extremely important that such techniques be considered and if available and advisable implemented as soon as possible after the testator's death.

II. THE USE OF TRUSTS IN A WILL AND TRUST TAX BASICS

Trusts are a very useful tool in an estate planner's tool kit. An *inter vivos* trust is sometimes referred to as a "living trust", as the person establishing the trust is doing so while he or she is alive. On the other hand, a testamentary trust is one which arises as the consequence of someone's death. This paper will focus on testamentary trusts. In this paper the terms "executor" and "estate trustee" are used interchangeably.

A. Types of Testamentary Trusts

There are numerous types of testamentary trusts, most of which arise through the deceased person's Will. Although there are many different types of testamentary trusts available, and indeed it is possible to prepare a customized testamentary trust for a particular need, this paper will focus on the more common forms of testamentary trusts.

1. Insurance Trust

An example of a testamentary trust that may arise either inside or outside of a person's Will is a life insurance trust. Although Wills often include a life insurance trust, it is not

necessary to establish the life insurance trust in a Will. The trust is considered to be a testamentary trust as it arises as a consequence of the deceased person's death. This is the case whether it forms part of the deceased person's Will or is a separate standalone trust outside of the person's Will.

A life insurance trust appoints one or more trustees as the beneficiary of the life insurance policy. The trustee will receive the life insurance proceeds and then hold the proceeds in trust for the beneficiaries of the life insurance trust. If the life insurance trust forms part of the Will, the executors are typically appointed to also act as the life insurance trustees, although this does not necessarily have to be the case. If a life insurance trust is to be drafted as part of the Will, care needs to be taken to ensure that the life insurance proceeds will not form part of the estate. Generally, life insurance proceeds pass to the beneficiaries outside of the estate. This avoids the need to pay probate fees on the value of the life insurance proceeds.

If the life insurance trustees are appointed as beneficiaries of the policy within the deceased person's Will, it is possible that the courts may take the position that the life insurance proceeds are assets of the estate and pass through the Will to the life insurance trustees (as opposed to passing by way of beneficiary designation). Whether this is the case or not depends on the drafting of the particular provisions of the Will. The Carlisle case[1] decided in Saskatchewan in 2007 has caused many Ontario

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[1] *Carlisle Estate (Re)*, 2007 SKQB 435 (CanLII).

solicitors to re-evaluate whether it is appropriate to include an insurance trust in a Will. Clause 6 of the Will in that case indicated that:

> I hereby declare that the proceeds of all policies of insurance on my life owned by me at the time of my death shall be payable and paid to the person who shall from time to time be acting as my Trustee, but such proceeds shall be paid to my Trustee in his capacity as insurance trustee, and not in his capacity as Trustee of my estate assets, and the proceeds shall be held by my insurance trustee, in trust, in the same shares and upon the same trusts, terms and conditions, as if such proceeds had formed part of the residue of my estate. It is my express intention that such insurance proceeds not pass through my will or estate, and this paragraph shall be a declaration within the meaning of The Saskatchewan Insurance Act, any successor or replacement legislation thereto and any similar legislation from time to time in force in any other applicable jurisdiction. Subject to the foregoing, my insurance trustee shall have the same powers, rights, protections, obligations and duties in connection with the administration of the insurance fund or funds as he has as a Trustee of my estate assets for the administration of the residue of my estate.

Notwithstanding the fact that the Will stipulated that "such proceeds shall be paid to my Trustee in his capacity as insurance trustee, and not in his capacity as Trustee of my estate assets," and "It is my express intention that such insurance proceeds not pass through my will or estate, and this paragraph shall be a declaration within the meaning of The Saskatchewan Insurance Act,", the court held at paragraph 35 that:

> The declaration in clause 6 of her will that the proceeds of all policies of insurance shall be paid to the executor of her estate makes those funds an estate asset.

Accordingly, the value of the life insurance proceeds had to be included in the probate application, and the appropriate probate fees paid.

Whether or not this approach will be taken by Ontario courts remains to be seen. There were specific facts applicable in the Carlisle case, and the legislation is slightly different in Saskatchewan. However, it appears that some Ontario solicitors have changed their

practice, and are recommending that clients have a standalone insurance trust outside the Will to avoid the possibility of a Carlisle-type of outcome.

2. Spouse Trust

A typical spouse trust will indicate that a portion of the residue of the estate is to be held in trust for the deceased person's spouse for the lifetime of the surviving spouse, and will identify how the amount remaining in the trust is to be dealt with after the death of the surviving spouse. These types of trusts are typically used in blended family situations, although they have also been used for income splitting purposes.

There are strict requirements that need to be adhered to in drafting a spouse trust. If there is an error in the drafting, the spouse trust may become "tainted", and may therefore lose the beneficial tax treatment associated with spouse trusts. Subsection 70(5) of the *Income Tax Act* (the "ITA") contains the general provision relating to the deemed disposition that occurs on death. Generally speaking, a person is deemed to have disposed of all capital property immediately before death and to have re-acquired that same property at fair market value. This may lead to capital gains and associated taxes thereon. A spouse trust may be used to defer the capital gains tax that would otherwise be payable on the death of the first spouse, often referred to as the "spousal rollover". Payment of tax on the capital gain would be deferred until the asset is disposed of or the death of the surviving spouse. Pursuant to subsection 70(6)(b) of the ITA, to qualify as a spouse trust:

> (i) the surviving spouse must be entitled to receive *all* of the income of the trust that arises before the surviving spouse's death, and

(ii) no person except the surviving spouse may, before the surviving spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust.

Further, in order to qualify for the "spousal rollover", the deceased spouse must have been resident in Canada immediately before his or her death, the spousal trust must be resident in Canada immediately after the property was transferred to it, and the property must vest indefeasibly in the spousal trust within 36 months of the first spouse's death. Failure to comply with any of the foregoing requirements may "taint" the spouse trust, and the spousal rollover will not be available.

Subject to the comments below with respect to the change in the taxation of testamentary trusts, spouse trusts have been used for income splitting purposes. Testamentary trusts are currently taxed at marginal rates. This has led to an income splitting opportunity, whereby allowing income to be taxed in a testamentary trust has essentially created an additional taxpayer with graduated rates.

A trust is not a separate legal entity, but a trust is a separate taxpayer for income tax purposes. Income earned in a trust may be retained and taxed in the trust or distributed to the beneficiary and taxed in the hands of the beneficiary. Accordingly, the creation of an additional taxpayer with graduated rates has been a useful tool in many estate plans for income splitting purposes. If two spouses each have a high income and are being taxed at high marginal rates, there may be an income splitting opportunity by having all of the assets of the deceased spouse pass through the Will to a spouse trust for the surviving spouse.

For example, assume the surviving spouse has a high income and is paying combined federal/provincial income tax at the rate of 46%. If income earned in the spouse trust was distributed to the surviving spouse and taxed in the hands of the surviving spouse, it would be taxed at that high rate. On the other hand, if the income was taxed in the trust, it would be taxable at the applicable marginal rate, which could be significantly lower. Due to the changes of the tax treatment of testamentary trusts discussed below, the income splitting benefits of spouse trusts (and, for that matter, most testamentary trusts), have been substantially reduced, but not eliminated.

Spouse trusts are useful in blended family situations. For example, if the current marriage is the second marriage for the wife, and she has children from the first marriage, she may wish to provide for her current spouse during his lifetime, but also wish to benefit her children in the long run. A typical spouse trust will indicate that the portion of the residue that is being held in the spouse trust (i.e. the capital) will be held in trust for the benefit of surviving spouse during the lifetime of the surviving spouse. All income generated by the spouse trust will be paid to the surviving spouse during his lifetime. When the surviving spouse dies, the amount remaining in the spouse trust will be paid to the children of the first marriage.

As was mentioned above, much care must be taken in drafting spouse trusts, as many spouse trusts have been found to be “tainted” due to drafting errors by the solicitor preparing the Will.

3. Spendthrift Trust

Testamentary trusts may also be used for control purposes where the testator has concerns about the beneficiary's ability to manage money prudently. A trust of this nature may indicate that the beneficiary is not entitled to receive any of his or her inheritance until a specific point in time, or may indicate stages in which the beneficiary will receive the inheritance over time. The trust provisions may offer guidance to the trustee or may be fully discretionary. It may be advisable to include a clause in the Will that would permit the trustee to wind up the trust early if it becomes too administratively burdensome to manage the trust, or if the cost of administering the trust may exceed the benefit to the beneficiaries. This type of trust may add a layer of creditor protection, depending on the drafting, as the beneficiary may not be entitled to receive any of the funds until and unless the trustee determines. The inheritance, then, would not have vested in the beneficiary, and the trust assets may then be protected from creditors seeking to enforce against the beneficiary by going after the trust assets.

4. Henson Trust

"Henson" trusts are often set up for disabled beneficiaries who qualify for the Ontario Disability Support Program ("ODSP"). The name of this type of trust arises from the 1987 case of *Ontario (Minister of Community & Social Services) v. Henson*[2].

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[2] (1987), 28 E.T.R. 121, 26 O.A.C. 332 (Div. Ct.), affirmed 36 E.T.R. 192 (Ont. C.A.).

A disabled person who is receiving ODSP benefits is limited in the amount of assets that he or she may own and the income that he or she may receive in a given year. Receiving a sizable inheritance may result in a claw-back of the ODSP benefits, or potentially disqualification, such that the person would no longer qualify for any benefits. Besides the income component, there are many benefits, such as medical and dental coverage, that a disabled person may be receiving. Setting up a Henson trust will allow the beneficiary to continue to receive ODSP benefits, while also being able to receive an inheritance under a Will.

A Henson trust gives the trustee full and absolute discretion to determine how much, if any, of the trust funds are to be paid to the beneficiary at a given time. The language in the Henson trust will stipulate that it is the intention of the testator that the trustee take into account the government benefits to which the beneficiary is entitled. Because the beneficiary does not have a vested interest in the assets of the trust, ODSP benefits are not affected.

It may be the case that the Henson trust generates more income than the amount being distributed on an annual basis. A typical Henson trust will indicate that any such surplus income will be added to the capital and treated as part thereof. In drafting a Henson trust, it is important to address the 21-year rule that arises under the *Accumulations Act*[3]. Income cannot be accumulated in the trust for more than 21 years. After the 21-year period, the income that has been accumulated must be paid out. Accordingly, the

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[3] R.S.O. 1990, c.A.5.

trust provisions must indicate to whom the excess is to be paid. If the payment is made to the disabled beneficiary, and assuming that the beneficiary is still, at that time, receiving ODSP benefits, the payment may be of a large lump sum, thereby affecting ODSP benefits. Ordinarily, the Henson trust will indicate that after the 21 year period, the excess is to be paid to other family members. Note, however, that due to the changes in the taxation of testamentary trusts, such a clause may lead to the Henson trust not qualifying as a Qualified Disability Trust ("QDT") as that term is defined in the new legislation. See the discussion below. While the Henson trust qualifies as a QDT, it will continue to enjoy the marginal tax rates that are currently available to testamentary trusts. If the Henson trust does not qualify as a QDT, income generated and taxed in the trust will be taxed at the highest marginal rate. If the trust initially qualifies as a QDT but later becomes disqualified, there may be a claw-back of the tax benefits that have been enjoyed during the years that the trust qualified as a QDT.

B. Changes to the Taxation of Testamentary Trusts

The Canadian government has recently changed the rate at which income retained in testamentary trusts will be taxed. Testamentary trusts currently enjoy marginal tax rates. If a testamentary trust earns a relatively low amount of income, it is taxed at a relatively low tax rate. If the trust earns a significant amount of income, it is taxed at a higher rate.

As of January 1, 2016, income retained in a testamentary trust will no longer enjoy graduated tax rates. Instead, income retained in the trust will be taxed at the highest marginal tax rate in the same manner as an *inter vivos* trust. This will affect all

testamentary trusts going forward, and will also affect existing testamentary trusts. There are no grandfathering provisions.

Although this change will reduce the availability of income splitting through testamentary trusts, it will still be possible to split income in situations where the income will be distributed to, and taxed in the hands of, a beneficiary in a low tax bracket.

There are two exceptions to the new rules. The new legislation has introduced the new Graduated Rate Estate ("GRE") and Qualified Disability Trust. In these limited exceptions, the marginal tax rates are still available.

1. Graduated Rate Estate

The GRE of an individual at any time is the estate that arose on and as a consequence of the individual's death, if that time is no more than 36 months after the death and the estate is at that time a testamentary trust. In general terms, a typical estate will be a GRE and will be entitled to the graduated rates for the first 3 years.

Consistent with the intention that that there be only one GRE in respect of a deceased individual, for an estate to be an individual's GRE at any time, a number of other conditions must also be satisfied:

- the estate must designate itself, in its T3 return of income for its first taxation year (or if the estate arose before 2016, for its first taxation year after 2015), as the individual's GRE;
- no other estate can have designated itself as a GRE of the individual; and

- the estate must include the individual's Social Insurance Number (or if the individual has not been assigned a Social Insurance Number before the death, such other information as is acceptable to the Minister of National Revenue) in its return of income for each taxation year of the estate that ends after 2015 and before that time.[4]

2. Qualified Disability Trust

Trusts for certain disabled persons will also qualify for the graduated tax rates for income retained in the trust, provided they satisfy the requirements of the new legislation. It is possible that existing Henson trusts may not meet the new requirements.

The disabled person must qualify for the federal disability tax credit, various technical rules must be complied with, and the disabled person must file a joint election with the trustee to treat the trust as a QDT. This may be an issue if the disabled person does not have the required legal capacity to make the tax election. Additional steps may need to be taken to ensure that the disabled person has a legal guardian who can file the election on his or her behalf.

It is also important that no one other than the disabled beneficiary be entitled to any capital distributions from the trust during the lifetime of the disabled person. Some existing Henson trusts may allow for distributions of capital to other beneficiaries,

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[4] *Explanatory Notes Relating to the Income Tax Act, Excise Tax Act and Related Legislation*, Department of Finance, August 2014.

particularly after accumulating income for 21 years. If the trust terms are not amended, the trust may not qualify for graduated rate taxation, or there may be a claw-back after the capital distribution is made.

A person may only be the beneficiary of one QDT. Additional planning may be required if more than one family member has set up a disability trust for the same disabled person.

III. THE USE OF MULTIPLE WILLS TO AVOID PROBATE FEES

A. Probate Generally

Depending on the nature of the assets, the executor may need to obtain a Certificate of Appointment of Estate Trustee (commonly referred to as “probate”) in order to deal with certain assets solely owned by the deceased. If the person died having a valid Will, the Will gives the executors the legal authority to deal with the affairs of the deceased person. Technically, probate does not grant the executors any more power than the Will does. The probate process is essentially the court confirming that it is satisfied that the Will is the Last Will and Testament of the deceased, and that the persons named in the probate Certificate are the estate trustees with authority to deal with the affairs of the deceased person.

B. When Probate May Be Required

If the deceased person died without a Will ("intestate"), no one will have authority to deal with assets solely owned by the deceased person, including a surviving spouse. A probate application may be required if the deceased person had any assets of significance.

A probate application may also be required if the deceased person had a valid Will. If the deceased had significant assets in his or her sole name at a financial institution, the financial institution may require probate prior to releasing the assets to the executor. If the deceased had a policy of life insurance or registered investments but did not have a beneficiary designated at the time of death, the life insurance company or financial institution may require probate in order to release the proceeds to the executor. The general rule in Ontario is that in order to deal with real estate owned in the sole name of a deceased person, the executor must first obtain probate. There are exceptions, such as the First Dealings exemption, which may permit the property to be dealt with without probate, provided certain requirements are satisfied.

C. Dual Wills to Reduce Probate Fees

In certain circumstances, it may be possible to reduce the amount of probate fees payable by having more than one Will per testator. If a Will must be submitted to probate in Ontario, probate fees of approximately 1.5% must be paid on the assets

passing through the Will[5]. Depending on the nature of the assets, it may be possible to reduce the amount of probate fees payable by having multiple Wills.

The "dual Will" or "multiple Will" strategy has been used in Ontario for many years. In the 1998 case of *Granovsky Estate* v. *Ontario*[6], J. Greer confirmed at paragraphs 32 and 33 that:

> There is no prohibition in our legislation which prevents a testator from having both a Primary and a Secondary Will.
>
> In the case at bar, there is no need for the Estate Trustees to prove both the Primary and the Secondary Wills since they are able to deal with the assets under the Secondary Will without probate. In my view, there is no legislative prohibition against asking the Court for a limited grant of the deceased's Primary Will and I find that there is no requirement for the Estate Trustees to submit the deceased's Secondary Will to probate or to pay probate fees on the value of the assets governed by it.

D. How it Works

Although a probate application may be required in order to deal with certain assets, as described above, there are other assets that may be dealt with without a probate application. If these other assets are of significant value, it would be prudent to develop a plan by which these other assets are dealt with outside of the Will subject to probate.

The Dual Will strategy involves each testator completing two Wills. One Will will be subject to probate, while the other will not. The Will that will be subject to probate is often referred to as the Primary Will, and the assets passing through the Primary Will as

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[5] Pursuant to subsection 2(6) of the *Estate Administration Tax Act, 1998*, S.O. 1998, c.34.
[6] 1998 CanLII 14913 (ON SC).

the Primary Estate. The other Will may be referred to as the Secondary Will, and the assets passing through the Secondary Will as the Secondary Estate.

Typical assets that may be dealt with without probate include:

- shares in privately held corporations;
- assets held in trust for the testator by private corporations and amounts owing to the testator from private corporations;
- beneficial interests of the testator in a trust;
- unsecured loans owing to the testator;
- certain real property interests; and
- personal effects.

Typically, the executors of the Primary Will and Secondary Will are the same. It is prudent to include a clause that will permit the executor of the Secondary Estate to disclaim entitlement to receive any property that would otherwise form part of the Secondary Estate. In other words, the executor would be given the discretion to decide which assets will pass through the Primary Will and which assets will pass through the Secondary Will. If such authority is not given to the executor, there may be undesired consequences if a particular asset must be dealt with under one of the Wills to the exclusion of the other. For example, if it will be necessary to obtain probate for one of the items listed as part of the Secondary Estate, it may be necessary to subject the Secondary Will (and the entire Secondary Estate) to probate. If the executor is permitted to include the particular asset as part of the Primary Estate, the remaining

assets of the Secondary Estate may still be dealt with through the Secondary Will without probate.

E. Example of Probate Savings

Assume the following simple fact scenario, ignoring the possibility of complicating factors such as claims of dependents or creditors: Mr. Smith is widowed and operates a successful business. He owns 100% of the shares. The business is valued at $2,000,000. He has $500,000 in cash and unregistered investments in his sole name at one financial institution. He owns a home that he purchased with his wife in the 1960s, which home is currently valued at $1,000,000. The home is eligible for the First Dealings exemption (i.e. probate is not necessary). He also owns a cottage property that was purchased in 2010, which cottage property is currently valued at $500,000. The cottage is not eligible for the First Dealings exemption (i.e. probate is required). He owns no other assets. The current total value of his estate is $4,000,000. Assume that at the time of his death the asset structure and values remain the same.

<u>Scenario # 1 – One Will</u>

Based on the circumstances, a probate application will be required. It is likely that his financial institution will require his executors to obtain probate, as it is holding $500,000 of assets in Mr. Smith's sole name. Further, as the cottage is not eligible for the First Dealings exemption, a probate application will be necessary in order for his executors to deal with the cottage property.

For the purposes of the probate application, the value of *all* of Mr. Smith's assets must be included, notwithstanding the fact that some of the assets could have otherwise been dealt with without probate. Accordingly, probate fees would need to be paid on the value of his entire estate. Based on the value of $4,000,000, probate fees would be $59,500. As a probate application is necessary in the administration of Mr. Smith's estate, his executors are not able to deal with his home without probate, notwithstanding that the First Dealings exemption would have otherwise been available.

Scenario # 2 – Dual Wills

If Mr. Smith had dual Wills, much of the value of his estate would be able to pass through his Secondary Will. The private company shares and his home would form his Secondary Estate. The probate fees would be reduced considerably. His unregistered investments and cottage property, valued at $1,000,000 in total, would form his Primary Estate, while the private company shares and home, valued at $3,000,000, would form his Secondary Estate. The Primary Will would be submitted for probate, allowing his executors to deal with the cottage and to access his unregistered investments. The Secondary Will would not be submitted for probate. Total probate fees payable on the Primary Estate would be $14,500. By using the dual Will strategy, there would be an additional $45,000 available for distribution to the beneficiaries.

It is important to note that the dual Will strategy is currently available in Ontario. It is not available in all jurisdictions. There is no guarantee that the government will not change the laws, removing this strategy as a viable option. For the time being, however, it is a

very useful strategy, especially where the testator has significant assets that may be dealt with without an application for probate.

IV. ASSETS PASSING OUTSIDE THE ESTATE

A. Life Insurance, Pensions and RRSPs/RRIFs/TFSAs

If a valid declaration/designation is made, life insurance proceeds, Registered Retirement Savings Plans ("RRSPs"), Registered Retirement Income Funds ("RRIFs") and Tax-Free Savings Accounts ("TFSAs") can be passed to beneficiaries without the value falling into the testator's estate for probate purposes. The impact of such plans passing to beneficiaries for income tax purposes will not be affected by such declarations/designations, but it will avoid the scrutiny and cost of the probate process, and pursuant to various legislation will also pass such assets to beneficiaries without exposure to creditor claims (although dependants may claw back certain assets to satisfy dependant relief claims pursuant to Part V of the *Succession Law Reform Act* (Ontario)[7]).

It is a good idea to review any declarations and designations a client has made to ensure they are current and provide for alternate beneficiaries in the way that the client would wish. This is particularly the case where there is a change in circumstances, for example, a marital breakdown. A common misconception is that if a person separates

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[7] R.S.O. 1990, c.S.26.

from his or her spouse, on death their spouse will automatically lose entitlement to such proceeds under existing designations and declarations naming the spouse. Caselaw in a number of estate disputes has confirmed that this assumption is not correct, and only compelling written evidence that the deceased intended to change his/her beneficiary designation(s) may be accepted by a Court in this regard.

Further, if it is possible that minor children may inherit such plans/funds, a trust set up under the testator's Will may be more effective and in keeping with their wishes regarding when the child will have access to capital than simply naming the child on a plan designation form, even with a trustee named. If the institution from is used, the child will be entitled to the funds on age 18 and the trustee will have very limited ability to use the funds for the child's benefit until that time.

Pensions are a special asset which are generally governed by the terms of the pension plan itself. Often a spouse, married or common-law, will have priority rights even over a designated beneficiary of a pension plan. Care should be taken to review the plan terms and consider any necessary changes to the testator's Will or estate plan depending on the plan terms and the testator's wishes.

B. Jointly Held Assets

Assets which are held jointly with right of survivorship will pass to the surviving owner(s) without passing through the testator's estate, although this does not mean that no income tax consequences will flow to the testator's estate due to the deemed disposition of such assets on the testator's death.

Joint asset ownership is a popular estate planning technique implemented by many people to avoid probate fees on the value of such assets. Problems can arise with such plans, for example if the testator's intention does not match the joint ownership and the surviving owner claims beneficial ownership of the asset. In addition, where the joint ownership was intended for asset administration only, probate fees on the value of the asset will not be avoided, since the surviving owner holds the asset for the benefit of the estate which must therefore include the asset's value in calculating the overall estate value. This is generally a problem for financial assets but can also arise in the context of joint ownership of real property – see for example the recent case of *Mroz* v. *Mroz*[8].

Family disputes can arise in determining who is the intended owner of the asset after the death of the primary asset holder. In *Pecore* v. *Pecore*[9], the Supreme Court of Canada conclusively settled the question of how and when the presumption of resulting trust applies, holding that financial accounts held jointly with adult children are held by the adult child on resulting trust for the benefit of the parent's estate, but this presumption is rebuttable upon adequate evidence of intention to gift the account to the child. Numerous estate disputes have arisen both before and after this ruling regarding jointly-held assets, and it is therefore important to properly document the testator's intention with respect to any jointly-held assets, including in the Will itself.

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[8] 2015 ONCA 171 (CanLII).
[9] [2007] 1 S.C.R. 795, 2007 SCC 17 (CanLII).

C. *Inter Vivos* Trusts

Inter vivos trusts are a planning technique which may become more popular with the new rules regarding testamentary trust taxation coming into effect in 2016 and the new Ontario *Estate Administration Tax Act* reporting regime which came into effect January 1, 2015, particularly alter-ego and joint-partner trusts. Testators can set up such trusts during their lifetime and any assets in the trust will pass outside of their estate. Some trusts include a power of appointment over the trust property after the testator's death, so that the testator's Will or another document may govern the disposition of the trust assets, although they still pass outside of the testator's estate. However, there will be a deemed disposition of assets rolled into such trusts, unless the trust is an alter-ego or joint partner trust.

Alter-ego trusts and joint-partner trusts are special types of *inter vivos* trusts which taxpayers who are resident in Canada and 65 years of age or older can set up for themselves alone or themselves and their spouse/common law partner. One benefit of such trusts is the ability to roll assets into them tax-free.

When implementing estate planning for a testator with an interest in an existing trust, the trust terms should be reviewed so that any powers of appointment or other powers can, if wished, be exercised by the testator in his/her Will or other document as allowed by the trust terms.

D. Bare Trusts

Another technique which can be used for probate minimization planning is to hold assets in the name of a trustee or corporation as a bare trustee for the testator. Such planning should be done in conjunction with multiple Will planning to effectively avoid probate fees (Estate Administration Tax) on the value of such assets, since beneficial ownership will continue to be held by the testator where a bare trust is employed, in contrast to *inter vivos* trusts where both legal and benefical ownership passes out of the testator's hands.

E. Gifts and Gifts Mortis Causa

Gifting during lifetime can be the easiest and simplest way for a testator to bypass probate, avoid estate administration complications and ensure that ownership of an asset goes to the person intended. There will be income tax consequences to the testator by way of a deemed disposition of such property immediately upon transfer of the beneficial ownership, but in many cases this can be acceptable and in certain circumstances may be spread out over more than one year to minimize taxes. To effect such gifts, however, the beneficial ownership and physical possession must usually actually pass to the donee: the donor cannot keep the benefit and avoid probate at the same time.

Gifts *mortis causa*, or deathbed gifts, are a type of gift made when the donor knows that they are mortally ill or nearing death, and wishes to gift property to the donee before they die. In the case of these gifts, it is not necessarily the case that physical

possession of the property must pass to the donee prior to the donor's death, but other rules apply, and generally this is not a recommended planning technique except in emergency circumstances and if possible with clear documentation or other contemporaneous evidence of intention.

F. More Complex Extra-Estate Planning

There are other planning techniques which are more complicated and require the assistance of experts, including tax advisors and others, in order to properly implement. Such techniques include the use of annuities, more complex life insurance products or ownership structures, and estate freezes, and are beyond the scope of this paper. None of these should be undertaken by an inexperienced estate planning lawyer without proper information, research and adequate experienced advisors available for consultation.

G. A Note About RESPs

Registered Education Savings Plans ("RESPs") are a popular vehicle for investing for a child's education, given the matching donations provided by the Federal Government to funds invested in an RESP and the ability for funds to grow tax-free in an account until withdrawal. However, it is very important to remember that RESPs continue to be the property of the account holder(s) (usually one or both parents or a grandparent) during their lifetime, and unless special provisions are put in the account holder's Will, RESPs will fall into the residue of the estate and must be liquidated with other assets, which is not usually the account holder's intent.

V. ESTATE PLANNING CONSIDERATIONS FOR FOREIGN ASSETS[10]

Given society's increased mobility and the globalization of our assets, it is becoming more common to own property outside of Canada, either in the U.S. or elsewhere, or in multiple jurisdictions. If your client owns property in another jurisdiction, you will need to consider the legal, tax and practical implications of such ownership, and whether or not special planning in respect of any of such assets is advisable in your client's individual circumstances.

In considering these issues, you and your client should have regard to the expense of such planning, the value of the assets in question and the benefits such planning will provide. It is most likely that additional advisors will be needed in order to advise on local tax and legal matters and review the Canadian planning documents and/or draft documents in the foreign jurisdiction. In some cases, the services of a translator may be necessary in order to ensure that all parties understand the documents and can effectively comment on them.

A. Cross-Border Canada-U.S. Considerations

1. Definition of a U.S. Person

"U.S. Persons" for U.S. estate, gift, and generation-skipping transfer tax (together, "U.S. transfer taxes") purposes include anyone who is a U.S. resident and has a U.S.

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[10] Some parts of this section of this paper have been taken or adapted from the O'Sullivan Estate Lawyers Client Advisories *Multijurisdictional and Separate Situs Will Planning* and *Will and Estate Planning Considerations for Canadians with U.S. Connections*, full texts of which can be found at www.osullivanlaw.com/Advisory-Letters/.

domicile, including a dual citizen of the U.S. and another country. In addition, U.S. citizens and greencard holders are also considered U.S. Persons for transfer tax purposes.

It is important to remember that it is possible to be a U.S. citizen without being aware of this status. For example, a person may be a U.S. citizen if they were born in Canada to one or more U.S. citizen parents, even if they have never resided in the U.S. There are also other types of "accidental" U.S. citizens, including children born in U.S. hospitals. A person may also be a U.S. Person if they have moved to the U.S. to work and have a U.S. domicile because they intend to permanently reside in the U.S. It is therefore important to probe further with clients to ensure that they are not U.S. Persons without knowing it, as the question “are you are U.S. Person/citizen” may not necessarily be answered accurately, although unwittingly so, by the client.

2. U.S. Transfer and Other Tax Consequences Arising from Being a U.S. Person

In addition to U.S. transfer taxes, U.S. Persons are subject to the U.S. income tax regime and must file an annual tax return. Additional reporting requirements may apply to U.S. Persons with Canadian bank accounts, RRSPs, TFSAs or certain other plans and investments. Punitive tax consequences are also levied on U.S. Persons who have an interest, even indirectly as a discretionary beneficiary of a Canadian-resident trust, in a passive income corporation, for example.

U.S. Persons are generally liable for U.S. estate tax on the gross value of their worldwide estates, subject to allowable exclusions, deductions and credits, as well as

U.S. transfer taxes, including, for example, gifts to a spouse or children.

3. Canadian Non-U.S. Persons Potential U.S. Transfer Tax Exposure

Canadian tax residents who are not U.S. Persons are generally liable for U.S. estate tax on their U.S. *situs* property, including U.S. real estate and tangible personal property and certain U.S. securities and other assets. They may also be exposed to U.S. transfer taxes on the value of their U.S. *situs* property gifted or transferred during their lifetime.

4. U.S. Transfer Taxes

In general, U.S. estate tax is calculated at graduated rates based on the gross value of certain assets owned by an individual at death. Currently, the maximum rate of U.S. estate tax is 40%. For a U.S. Person, the tax is based on the value of his or her worldwide estate, subject to applicable exclusions, credits and deductions. For a non-U.S. Person, the tax is based on the value of his or her U.S. *situs* property. Pursuant to the Canada-U.S. Tax Treaty, non-U.S. Persons who are subject to U.S. estate tax on their U.S. situs property are allowed a prorated exclusion amount based on the ratio of their worldwide property value compared to the value of their U.S. situs property. U.S. estate tax may be payable where the value of their worldwide estate exceeds the U.S. estate tax exclusion amount (currently $5 million USD indexed for inflation from 2011, and $5.43 million USD for 2015).

The worldwide estate for U.S. estate tax purposes includes certain assets that may not be obvious, such as the proceeds of life insurance policies owned by a deceased

person on his or her own life, generally the total value of property held in joint tenancy with right of survivorship (subject to limited exceptions and deductions), and certain property held in trust. In addition to U.S. estate tax which is levied at the federal level, certain U.S. states also levy estate or inheritance taxes on death, including Connecticut, Delaware, District of Columbia, Hawaii, Iowa, Illinois, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont and Washington.

In addition to estate tax, the U.S. transfer tax regime includes gift tax and generation-skipping transfer tax ("GSTT"). Generally, U.S. gift tax applies to gifts by U.S. Persons and to gifts of certain U.S. *situs* property by non-U.S. Persons, subject to exclusions and deductions. Gifts by U.S. Persons in excess of an annual exclusion amount may be tax-free up to the lifetime estate tax exclusion amount.[11] It is important to note that gifts made reduce the estate tax exclusion available on death and that certain U.S. tax filings may be necessary when gifts are made. GSTT generally applies to gifts valued above the exclusion amount, currently $5.43 million USD, that are made to unrelated persons at least 37.5 years younger than the donor and to or for the benefit of related persons at least two generations below the donor.

5. Possible Planning Strategies for Cross-Border Canada-U.S. Concerns

For the purposes of the following sections, I refer to a U.S. Person spouse as a "U.S.

[11] Gift tax exclusions include: for U.S. Persons generally, an annual exclusion of $14,000 in 2015; an annual exclusion of $147,000 for gifts by any person to a non-U.S. Person spouse in 2015; and unlimited exclusions for certain health care or tuition payments. In addition, a gift in any amount between two U.S. Person spouses of a present interest (as opposed to a future interest which vests in the gift recipient only upon some future date) is sheltered by the unlimited marital deduction from gift tax consequences.

spouse” and a non-U.S. Person spouse as a “Canadian spouse”.

a. For Spouses - Where One Spouse is a U.S. Person

i. Bypass Trust to Benefit a Surviving U.S. Spouse Under Canadian Spouse’s Will

Any assets transferred outright under a Canadian spouse’s Will to a surviving U.S. spouse if owned by the U.S. spouse at his or her death will be included in the U.S. spouse’s worldwide estate for U.S. estate tax purposes. As a result, it can be critical to ensure that the Canadian spouse’s assets are not exposed to any additional U.S. estate tax where the U.S. spouse’s available exclusion amount for U.S. estate tax will not eliminate any estate tax liability.

To minimize or eliminate U.S. estate tax, instead assets may be transferred to a “bypass trust” for the benefit of the U.S. spouse. Assets in the trust are not included in the U.S. spouse’s worldwide estate on his or her death, provided the trust meets certain requirements. These requirements include limits on the U.S. spouse’s participation in certain discretionary decisions, including to pay income or capital so that he or she does not have too much ownership, resulting in the value of the assets of the bypass trust being included in his or her estate on death, and as a result, subject to U.S. estate tax. The requirements are detailed and U.S. counsel should review all such planning to ensure a trust qualifies and includes all recommended provisions.

For Canadian tax purposes, assets with accrued capital gains may be rolled over to the bypass trust on a tax-free basis if it is also a qualified spouse trust under the *Income Tax Act* (Canada) (usually this is not a problem since the Canadian rules are much

simpler than U.S. bypass trust requirements and the rule are compatable). The assets in the trust will not be subject to tax until the earlier of the date they are disposed of and the death of the U.S. spouse.

ii. Qualified Domestic Trust Under U.S. Spouse's Will

Transfers from a U.S. spouse to a Canadian spouse generally do not qualify for the unlimited marital credit available to two U.S. spouses which would allow a deferral of U.S. estate tax assuming the Canadian spouse survives the U.S. spouse. One exception allows a U.S. spouse to pass assets at death to a Canadian spouse by means of a special trust called a Qualified Domestic Trust ("QDOT"). Under U.S. rules, the estate tax otherwise due on the death of a U.S. spouse is paid upon distribution of any capital of the trust to the surviving Canadian spouse or ultimately upon the Canadian spouse's death. It is important to note that the QDOT only *defers* U.S. estate tax (much like the deferral of capital gains available for Canadian tax purposes for property passing between spouses) that otherwise would have been imposed. The deferred tax is generally imposed at the Canadian spouse's death on the gross value of the property remaining in the QDOT. Therefore, if the value of the QDOT property increases, the tax at the Canadian spouse's death could be higher than if the tax had been paid at the death of the first spouse.

A QDOT must meet a number of complex requirements, including that it must have at least one U.S. trustee and the trust must be governed by the law of a U.S. state.

iii. Planning For Use of Spousal Credit Under the Canada-U.S. Tax Treaty Under U.S. Spouse's Will

The Canada-U.S. Tax Treaty provides special relief. It allows a spousal credit to be taken by a U.S. spouse against U.S. estate tax. The spousal credit *is in addition* to any unified credit or exclusion amount for U.S. estate tax. To qualify for the spousal credit, the property must pass to the surviving Canadian spouse in a manner that would otherwise qualify for the U.S. marital deduction: 1) outright, or 2) to a special trust called a qualifying terminable interest property ("QTIP") trust which qualifies for the marital deduction (discussed further below).

The spousal credit is approximately equal to the lesser of the unified credit or the estate taxes imposed on the qualifying property, which can allow for up to approximately $10.86 million USD in 2015 of assets to pass from a U.S. spouse to his or her Canadian spouse free of estate tax, or approximately double the exclusion amount.

iv. Credit Shelter Trust under U.S. Spouse's Will

A "credit shelter trust" can be established in a U.S. spouse's Will in an amount up to the exclusion amount in order to fully utilize the U.S. spouse's estate tax exclusion so that the trust assets may eventually pass to the Canadian spouse free of estate tax.

v. Life Insurance

The Canadian spouse may consider purchasing life insurance on the life of the U.S. spouse in an amount sufficient to fund his or her expected U.S. estate tax liability. In

addition, life insurance on the life of the Canadian spouse may be designated to a bypass trust for the benefit of the U.S. spouse. As well, insurance may be owned through a special trust called an irrevocable life insurance trust, as opposed to direct ownership, to exclude the value of the proceeds from the estate of the U.S. spouse.

vi. Holding Assets Between Spouses

Consider structuring real property holdings to minimize U.S. estate tax, as real property held in joint tenancy with right of survivorship is presumed to be included at its full value in the estate of the U.S. spouse (except to the extent the Canadian spouse can establish the extent of his or her contribution to the purchase price), and the value of any mortgage is generally not deductible from the property value. Canadian real estate might be held solely by the Canadian spouse, so as not to be included in the estate of the U.S. spouse. Conversely, any U.S. real estate might be held in the name of the U.S. spouse, among other possible arrangements or consider holding assets of fixed value in the estate of the U.S. spouse and assets which are expected to appreciate in the estate of the Canadian spouse. It is important to carefully consider and seek professional advice with respect to acquiring and holding property in order that all relevant tax and legal considerations are taken into account in each individual case.

b. For Spouses – Where Both Spouses are U.S. Spouses

Where both spouses are U.S. spouses and the gross value of one spouse's estate, net of the gift tax exclusion used prior to death, exceeds the exclusion amount ($5.43 million USD for 2015) resulting in possible U.S. estate tax exposure, the following

planning options may be available in planning for the spouse who predeceases.

i. Unlimited Marital Deduction

Transfers on death from a U.S. spouse to a U.S. spouse, outright or through a QTIP trust under each Will, allow for an unlimited marital deduction against estate tax, providing a deferral of any U.S. estate tax until the death of the surviving spouse or payment of capital from the spouse trust. A QTIP must meet certain legal requirements to qualify.

From a Canadian tax perspective, a QTIP trust may also meet the requirements of a qualifying spouse trust under Canadian tax legislation. Assets transferred on death by a deceased spouse to a qualifying spousal trust may be "rolled over" and are not subject to tax until the earlier of the date the asset is disposed of by the trust and the death of the surviving spouse.

ii. Credit Shelter Trust

A "credit shelter trust" can be established under each Will, generally funded in an amount up to the exclusion amount, in order to ensure a U.S. spouse's estate tax credit is utilized so that the amount allocated to the credit shelter trust passes to his or her intended beneficiaries free of estate tax. This type of trust acts like and is sometimes called a "bypass trust".

iii. Portability of Exclusion Amount

As between two U.S. spouses, the exclusion amount of approximately $5.43 million

USD for 2015 is portable, so that if one spouse dies, any unused exclusion of the deceased spouse may be transferred by making certain elections to the surviving spouse, subject to certain terms and conditions. Effectively, this can allow up to approximately $10.86 million USD in 2015 of assets to pass free of estate tax for a U.S. couple. However, care should be taken in relying on this exclusion: if the surviving spouse remarries, the deceased's spouse's unused exclusion amount may no longer be accessible to the remarried spouse, and may be lost.

iv. Life Insurance

Consideration can be given to purchasing life insurance on each spouse’s life in an amount sufficient to fund the expected U.S. estate tax liability. Life insurance if owned by a person other than the insured person will not be subject to U.S. estate tax. As well, consideration can be given to using an irrevocable life insurance trust, which must include special terms to qualify, as opposed to individual ownership, to remove the value of the proceeds from the taxable estate.

v. Charitable Donation Planning

To reduce the amount of a person’s U.S. estate, consider a donation to charity. Amounts donated to qualifying U.S. charities and certain qualifying international charities can provide for generous tax relief. Further, certain U.S. charities are also qualified charitable donees for Canadian tax purposes, and therefore donations to them will generate charitable donation tax credits in Canada as well as the U.S.

c. For Other Beneficiaries Who are U.S. Persons

Where the intended beneficiaries of an estate are the testator's children or grandchildren, who are or are likely to become U.S. Persons, a bypass trust under the testator's Will for their benefit in order to protect the assets they inherit from U.S. estate tax on their death(s) should be considered depending on the sums likely to be involved. As discussed above with regard to transferring assets by Will to a U.S. spouse, for U.S. estate tax minimization purposes, the trust must meet certain requirements, including restrictions on the ability of the beneficiary to participate in certain discretionary decisions with respect to the trust. Use of a trust may provide a host of other benefits as well, including ensuring capital succession to the next generation, minimizing probate fees because the assets in the trust on death of the beneficiary do not form part of his or her estate, and general wealth, matrimonial and creditor protection.

d. For Non-U.S. Persons Owning U.S. Situs Property

If your client owns U.S. situs property, such as a second home in Florida for example, exposure to U.S. estate tax and possible options to minimize this exposure should be considered. Some of the above planning techniques, such as transfer of ownership or life insurance to cover the expected tax, should be considered as potentially inexpensive and simple solutions. In cases where the expected tax is substantial or other options are not attractive, a special Canadian *inter vivos* trust to purchase and hold U.S. property can be set up which can remove the property from being subject to U.S. estate tax, although if the property has gained in value since purchase this may give rise to immediate tax implications and should be carefully explored before

implementation.

In all cases involving clients with U.S. connections, common U.S. planning techniques should be carefully explored and tax advice obtained before implementation, as some, such as owning U.S. real estate through a U.S. corporation or U.S. revocable trusts routinely set up for U.S. estate planning purposes, can have extremely negative tax implications for clients who also have Canadian connections, especially those who are or become tax resident in Canada.

B. Estate Planning Considerations for Clients with Connections to Other Jurisdictions (Not U.S. Specific)

1. Extra-Jurisdictional Laws' Effect on Property Passing on Death

a. Family Law Regimes and Their Effect on Succession

Family law rules may affect the succession of property upon death, depending on the specific jurisdictions and governing law involved. If one of the applicable matrimonial regimes is a form of community of property (*i.e.,* spouses' property and earnings are considered community property during marriage and are divided equally between them on marriage breakdown), there may be limitations on what property your client and their spouse may each dispose of by Will. Problems can arise where spouses are subject to one legal regime for matrimonial property, and another legal regime governs succession to property on death.

b. Conflict of Laws Issues

When it comes time to administer an estate with assets in multiple jurisdictions, one key issue may be which law governs the property rights of the testator and his/her spouse or family on death and the validity and effect of a testator's Will. When creating a succession plan for assets in multiple jurisdictions, it is important to be aware of the conflict of laws rules which determine succession of property. These rules are complex, often confusing, and unpredictable in how they will be applied to assets in jurisdictions outside the court of the jurisdiction where a principal Will is interpreted.

i. Common Law Jurisdictions – Testate Succession

In common law jurisdictions, the formal validity of a Will (which relates to its physical form and its manner of execution) is governed by: (a) the law of the testator’s domicile at date of death for personal property; and (b) the law of where the property is located for real estate. Further, the construction of the testator’s Will is interpreted according to the law they intend. At common law, there is a rebuttable presumption that this is the law of the testator’s domicile at the time of the execution of the Will. It is important to note that in some jurisdictions, statutory law may modify these rules.

ii. Civil Law Jurisdictions – Testate Succession

In civil law jurisdictions, assets and liabilities are directly transmitted to the heirs, as opposed to vesting in the personal representatives who “administer” the estate by collecting in assets, paying liabilities and distributing the remaining property to the beneficiaries. Regarding the governing law, some civil law systems have a separate

rule for personal property and the law of the location of the property for real estate, while other civil law systems are "unitarian"—applying the testator's personal law to all estate assets regardless of location.

2. Definitions - Multijurisdictional and Separate Situs Wills

A multijurisdictional Will is one testamentary document which governs the succession of assets in several different legal jurisdictions.

A separate situs Will is a distinct testamentary document concerning assets located in a particular legal jurisdiction (or "situs") and is typically executed in accordance with that jurisdiction's laws. A separate situs Will is used in conjunction with a principal Will that deals with all of the testator's other assets.

3. Benefits of Multijurisdictional and Separate Situs Wills

There are several strategic, practical and legal reasons for using a multijurisdictional Will and separate situs Wills. Depending on the assets and jurisdictions involved, and the testator's personal circumstances, the advantages may include: (a) ensuring the estate planning documents will be valid and that the testator's intentions are realized and given effect; (b) making the administration of assets upon death more efficient; (c) ensuring clarity by using local language and form; and (d) avoiding unnecessary probate costs.

a. Greater Capability to Ensure Validity

Using either a multijurisdictional Will or separate situs Will can help to ensure that the Will is valid and that assets will be distributed as the client intended. Local formalities can be complied with, which is particularly important when real estate is involved. In many jurisdictions, the local law where the real estate is located governs the formal validity of the Will as it applies to real estate. For example, there may be special form and execution rules. Some jurisdictions have unique execution requirements such as the need for *more* than two witnesses (which is the typical requirement in most jurisdictions with systems based on English law).

The local law of the foreign jurisdiction can be chosen to govern the Will dealing with assets in that jurisdiction, which can avoid future legal problems, including confusion regarding which law should govern the interpretation of the Will. Local counsel can ensure the separate situs Will's provisions are substantively valid under the local law and ensure that local law will give effect to the content of the Will on such matters as (a) how long income can be accumulated, (b) the period any trust under the Will can last before it must terminate, and (c) mandatory succession or forced heirship rules among family members where the local law requires a division of the estate of certain amounts or percentages. Similarly, the use of local language and local "legal terms of art" can be used, avoiding translation and interpretation problems down the road.

b. More Efficient Administration

By using a separate situs Will, the administration of the local estate can be restricted to a smaller and more identifiable group of assets, creating greater efficiency. The administration of the estate can proceed without delay because a separate situs Will can usually be directly submitted to probate without waiting for a Will to be probated in the client's jurisdiction of domicile and then trying to have it admitted in the second jurisdiction—a two-step process.

If separate situs Wills are not used, the local court may require the original Will. As there is only one original Will, problems may arise because the original Will may have already been submitted to the home jurisdiction court that granted the original probate. Problems may also arise, for example, if the original were retained by a foreign court, if the foreign jurisdiction does not have a recognizable form of probate which can be the subject of a resealing or ancillary grant, or if the foreign jurisdiction has a system of executorship which does not integrate well with Ontario Court rules.

c. Use of Local Language, Form and Rules

A separate situs Will can more easily incorporate local language and local formalities. The use of local language avoids a need for translation when it is time for the Will to be used in the jurisdiction. Using local form helps to ensure that the court process and administration of assets in the jurisdiction will proceed efficiently. Local rules may also dictate certain requirements that are not found in other jurisdictions. For example, local rules may require the executor to be a resident of the jurisdiction or require a foreign

executor to post a bond. A separate situs Will can be prepared with these jurisdiction-specific rules in mind—such as by appointing a local person to be executor in that particular jurisdiction.

d. Avoidance of Unnecessary Probate Costs and Privacy Concerns

Separate situs Wills can reduce the total cost of probate fees payable on death. Separate Wills for each of the jurisdictions in which the testator holds assets can avoid local probate fees being charged on their worldwide estate, and duplication of probate fees being paid in several jurisdictions on the same assets.

Separate situs Wills can also ensure greater privacy and confidentiality during the probate process if, based on local rules, only those assets and their values which are governed by the separate situs Will need to be disclosed during the probate process (as opposed to having to disclose the testator's worldwide assets).

4. Key Considerations When Preparing Multijurisdictional or Separate Situs Wills

a. Interpretation Issues

Problems can arise where local law under a separate situs Will governs interpretation and provides a different interpretation or definition for critical terms than those under the law in the testator's home jurisdiction. For example, does the use of the term "issue" or "children" under local law include or exclude adopted children or children born outside of marriage? Does the term "spouse" refer to only legally married spouses or also common law or same sex spouses under local law? Counsel in the different

jurisdictions need to work together to consider key terms and include specific definitions in the separate situs Will to avoid unintended results if local law would otherwise provide a meaning that is not in keeping with the testator's wish. Counsel should at all times avoid making assumptions based on their own local laws, since the other jurisdiction's laws may be very different in key respects.

b. Tax Liabilities

In developing a coordinated estate plan using a multijurisdictional Will or separate situs Wills during the planning stage, the testator's advisors should consider how the Wills will work together to create a unified whole and address the issue of tax liabilities. Counsel will need to consider and discuss with the testator as to which executors under which Will are liable to pay tax liabilities on death and to file tax returns in each jurisdiction. It may be necessary to apportion primary and secondary liability among the executors of multiple Wills. Counsel also need to consider the implications if one estate is insolvent or lacks sufficient assets to discharge the testator's tax and other liabilities.

A debts and taxes clause can be drafted in order to avoid problems which might otherwise arise. Where the testator has different beneficiaries under each estate, the impact of the allocation of tax liabilities and which estate bears the burden will be a key issue and can be the basis for a future dispute. The interpretation of the Will and express provisions relating to payment of debts and tax will be important if there is a

dispute. As an example, in *Barna Estate*[12]*,* where the testator had left valid Canadian and French Wills, a Canadian court considered whether the applicant, a beneficiary of the testator's estate, may be liable for French taxes on property passing under the French Will, and concluded it was not based on the drafting of the Canadian Will.

Counsel also need to consider the right a taxing authority has to enforce tax liabilities in a foreign jurisdiction against the executors of the estate in the foreign jurisdiction. A general rule of private international law states that the courts of one country will not enforce, directly or indirectly, claims made for taxes of a foreign government. For example, in *United States of America v. Harden*[13], the Supreme Court of Canada held that it would not enforce a judgment obtained in California for United States taxes in an action brought in British Columbia. The traditional basis for the rule is protecting the sovereignty of nations. Enforcing the tax claims of a foreign country may be viewed as an invasion of such sovereignty. In *Dubois v. Stringam*[14]*,* the Alberta court held that an Alberta administrator of an estate was not authorized to liquidate a farm in Alberta to pay funds to the United States executor of the estate to satisfy United States estate taxes, where the United States estate had a deficiency and could not otherwise pay all the tax.

However, protocols and conventions entered into between jurisdictions may modify this general rule. For example under the Canada-U.S. Tax Treaty, for the stated reasons of

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[12] 1990 CanLII 1228 (B.C. S.C.).
[13] [1963] S.C.R. 366, 1963 CanLII 42, 41 D.L.R. (2d) 721.
[14] 1992 ABCA 325 (CanLII), 135 A.R. 64, [1993] 3 W.W.R. 273 (A.B. C.A.).

avoiding double taxation and combating tax evasion, each of the United States and Canada will effectively collect taxes owing by their respective residents to the other in certain circumstances.

c. Creditors and Liquidity Issues

Counsel should consider and discuss with the testator which estate will be primarily responsible for the payment of debts, and whether foreign creditors of one estate can have recourse against the assets of the other estate in another jurisdiction. Consideration should also be given to whether the foreign debts are enforceable against the other estate. Prudent drafting techniques can be used to potentially avoid future problems in this regard. For example, each Will can provide a set of priorities regarding payment of creditors for that Will. A coordinated approach might entail appointing a principal executor under a principal Will who is ultimately responsible for all the debts.

Thought should also be given as to what recourse one estate may have against the other to pay legacies and bequests if one of them is deficient. Similarly, it is also important to consider how advances to beneficiaries may affect the distribution in one or more of the Wills.

d. Forced Heirship Claims

"Forced heirship" arises in many civil law jurisdictions where some or all succession rights are codified rather than subject to testamentary freedom. Typically, forced heirship provisions state that a certain portion of a testator's estate must pass to each forced heir, for example a spouse or a child. In many Muslim countries, for example,

more extended family members are entitled to certain portions of the estate (not always the same ones as each state varies in its rules), and only a percentage may be left to the beneficiaries of the testator's choosing. Consideration will need to be given to how the forced heirship rules of a foreign jurisdiction apply to an estate administered in another jurisdiction, where the principal Will or a separate situs Will is located in that other jurisdiction.

In the United States, courts have resisted enforcing forced heirship rights in property located in the United States, based on public policy principles of the states (except Louisiana) which disfavor forced heirship. In *Re Janes Renaud*, the New York court refused to allow forced heirship rights to be applied against bank and brokerage accounts in New York and disposed of under a Will drawn in New York in which the testator, a French domiciliary, designated that New York law apply. The deceased's son, a dual citizen of the United States and France, claimed that under French law, he was entitled to a forced share of the accounts. The court relied on the choice of New York law under the Will as determinative of the validity and effect of the disposition of assets located in New York. To my knowledge, there is no Canadian jurisprudence on this issue, although with the increasing mobility of our society I would expect that this issue will be adjudicated at some point.