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Advisory

Planning to minimize estate taxes under the *Estate Administration Tax Act 1998* (Ontario)

In this Client Advisory, we present an overview of Ontario's estate administration tax (formerly "probate fees") regime. As well, we highlight the extensive reporting now required once a "certificate of appointment of estate trustee with a will" (formerly called a "grant of letters probate") is granted by the court. We then briefly discuss various planning techniques to minimize exposure to this tax and the application of the new reporting scheme.

ONTARIO ESTATE ADMINISTRATION TAX

Ontario estate administration tax is paid in order to receive a probate certificate, under present Ontario court rules called a "certificate of appointment of estate trustee with a will", and most other types of certificates granted to executors and administrators of an estate, from the court. 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.* Further, if a person dies without a will, a certificate from the court (called a "certificate of appointment of estate trustee without a will") will almost always be necessary to appoint someone to administer the deceased's estate.

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 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.

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With the 1992 increase, the fees increased to 0.5% based on the first $50,000 of estate assets and 1.5% on the balance, making these rates among the highest of all North American jurisdictions, although in 2020 the fees on the first $50,000 of value were eliminated (effectively reducing the fees by $250 for most estates). As a result of these high fees, it has become 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, and 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* (the "Act"), 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.

REPORTING REQUIREMENTS UNDER THE ACT

In addition to the Act imposing a requirement to pay tax based on the value of the includable estate assets, the Ontario government implemented additional sections of the Act and enacted Regulation 310/14 under the Act, both of which came into effect on January 1, 2015 (amended effective January 1, 2020), which create a reporting regime tied to the probate

process. This reporting regime applies to anyone applying for and receiving a certificate of appointment of estate trustee (or other similar certificate) on or after January 1, 2015.

The "estate representative(s)" (usually the executor(s) named in the will or administrator(s) appointed by the court) are required to complete and file an estate information return with the Ministry of Finance within 180 calendar days of the court issuing a certificate of appointment. The return requires the estate representative to disclose certain information about the estate—most significantly, information regarding the fair market value at the date of death of each asset used to calculate the total estate tax payable. Estate representatives must be able to substantiate asset values as reported. Asset valuation can be complicated depending on the type of asset, and professional valuation and appraisal expertise may be required.

The Act's additional requirements include filing an amended return within 60 days of discovering any information originally provided is incorrect or incomplete, or the existence of any additional estate assets. In conducting its review of these returns, the Ministry of Finance is given broad audit powers. Penalties (including fines and imprisonment) are also possible for failing to file a return or in circumstances where the information previously reported on a return was false or misleading.

ESTATE TAX PLANNING – TECHNIQUES

Planning to minimize 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 a relatively 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:

Size of Estate	Estate Taxes Payable
$750,000	$10,500
$2 million	$29,250
5 million	$74,250
$10 million	$149,250
$15 million	$224,250

As a result of onerous reporting requirements, it is beneficial to plan to minimize estate taxes in order to lessen the amount of information that is required to be provided to the Ministry of Finance on an estate information return, as well as the cost and time involved in preparing and filing such a return and any necessary amended returns.

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, it is presumed that the person to whom the transfer has been made holds title to the property 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, including the need to file a Trust Income Tax and Information Return.

It is essential to consider all of the legal and tax implications of a proposed transfer of assets to joint ownership to determine whether this strategy is beneficial in the particular circumstances.

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 (other than where the

deceased's estate is the designated beneficiary), and instead, are directly payable to the designated beneficiary.

In Ontario, proceeds of RRSPs and other registered 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 insurance and registered plan proceeds if there is a designated beneficiary (other than where the deceased's estate is the designated beneficiary).

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 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 grant of probate for only the primary will. Estate taxes are then payable only on the assets covered by the primary will. The 1998 Ontario court decision in *Re Granovsky Estate* confirmed the validity of using multiple wills for this type of estate tax minimization.

Since the secondary will is not submitted for probate, the reporting requirements under the Act do not apply to the assets dealt with under that will. As a result, a secondary will may be useful in circumstances where it might be expensive or difficult to obtain property valuations, such as where the person owns shares of an active private business.

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 $525, 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. It may also be relevant where the costs associated with the new estate tax reporting requirements may be high, such as where the person owns an active business or other assets which are difficult and costly to value. Planning to reduce exposure to estate taxes requires not only a careful assessment of the estate tax and reporting costs 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, are limited to Ontario law 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.

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