Alternate Planning to Secondary Wills for Avoiding Probate and Estate Administration Tax

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Alternatives to Multiple Wills to Avoid EAT

Why is Estate Administration Tax an Issue?

- Ontario estate administration tax ("EAT") is essentially equal to 1.5% of the value of the assets passing under probate (*Estate Administration Tax Act, 1998*)
- Probate, or a Certificate of Appointment of Estate Trustee with a Will is generally required to transfer assets in Ontario following death of the owner
- Real estate in the name of the deceased, always requires probate unless it is a first conveyance following conversion from Registry
- Financial institutions generally require probate to transfer assets held in the name of the deceased

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Multiple Wills Technique to Avoid EAT

- The executor's authority is derived from the Will
- Probate is only the evidence of that authority
- Where the evidence is not required, assets may pass under the un-probated Will
- Examples include: shares in closely held private corporations, loans to closely held private corporations and family members, personal articles, real estate that was acquired under the old Registry system where it is a first conveyance after the conversion of the title to the Land Titles system

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Multiple Wills Technique

- The practice evolved where a testator would have one or more Wills such that assets not requiring probate could be distributed under a non-probate Will
- estate assets are not known until the testator dies
- Accordingly, the drafting of multiple Wills became very creative, including the so called basket clause to make sure that every asset that did not require probate be allocated to the non-probate Will
- *Re Milne*, 2018 ONSC 4174, put this drafting technique in jeopardy threatening to invalidate multiple wills

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Milne Estate (Re), 2019 ONSC 579

Validity of multiple Wills (appeal decision)

- Appeal from September 11, 2018 ONSC decision by Dunphy J. denying application for Certificate of Appointment for Primary Will on the basis of uncertainty
- The Court on appeal examined and ruled on the following issues:

1. Is a Will a trust?
   - No. A will may contain a trust, but that is not a requirement for a valid will.
2. Does a Will require the three certainties needed for a trust?
   - No, because a will is not a trust.
3. Did the Application Judge exceed his jurisdiction?
   - Yes. The Court's role on an application for a Certificate of Appointment is to determine whether the document is the testator's last Will. Broader questions of interpretation and the validity of powers conferred on trustees are matters of construction and not necessary to the grant of probate.

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Milne Estate (Re), 2019 ONSC 579

Validity of multiple wills (appeal decision)

- Even if a Will is a trust and the three certainties must be satisfied, the Court found that the certainty of subject matter of the Primary Will was satisfied
- Certainty of subject matter means (i) a trust must have property that can be clearly identified as its subject matter, and (ii) the share of each beneficiary must be set out
- The basis of identifying which property should go into the Primary Will versus the Secondary Will, being whether a grant of Court authority is required for the transfer of the property, was a sufficiently objective test to satisfy the certainty of subject matter

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Thinking Beyond Multiple Wills

Ongoing Concerns

- If there are different residual beneficiaries under multiple Wills utilizing a basket giving the executor power to allocate assets among two or more Wills, there remains a potential certainty issue, or at least exposure to post mortem litigation by the beneficiaries
- Ontario is not generating the revenue once anticipated from tripling the EAT
- It is possible Ontario may move at some future time to restrict the avoidance of EAT through the vehicle of multiple Wills

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Joint Property

Joint property ownership between spouse to avoid EAT

- Jointly held property between spouses can be an effective estate planning technique to avoid EAT where the will gifts the asset to the surviving spouse
- Property held as joint tenancy automatically transfers legal title by right of survivorship on death of joint owner
- Income attribution applies, so the transferor continues to pay tax on all income and capital gain generated by the transferred property

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Joint Property

Joint property ownership with children and others

- Transferring property to joint name with persons other than a spouse can be problematic
- If surviving joint title holder holds on trust for the transferor and his/her estate, the value of the property is subject to EAT if a probate is required for other assets (unless bare trust ownership assets are disposed of under a non-probate Will)
- Presumption of resulting trust applies to new joint owner, unless the transfer is to a spouse or minor child in which case there is a presumption of advancement

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Joint Property

- Resulting trust presumption assumes the joint owner holds on trust for the transferor
- But - owner of property may make a gift of “right of survivorship” of beneficial and legal title on death
- Concept introduced by the Supreme Court of Canada in *Pecore v. Pecore,* [2007]1 S.C.R. 795, 2007 SCC
- Property held in this manner will transfer legal and beneficial title automatically by right of survivorship on death of first joint owner and therefore pass the asset outside of the Will

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Joint Property

- The intention of the transferor determines whether there is a gift of survivorship (beneficial ownership)
- *Sawdon Estate v. Sawdon*, 2014 ONCA 101
- W. and S., 2 of 5 children were named joint holders of a bank account with A (their father)
- W. and S. were told by their father to share the funds with all 5 children on father's death
- Held that father created a trust of the right of survivorship such that W. and S. held the right of survivorship on trust for all 5 children

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Joint Property

Disadvantages

- True joint ownership involves a partial transfer of ownership to the new joint owner – triggers a disposition of capital property for income tax purposes
- Transfer of beneficial ownership prior to death – transferor may not be ready to give up ownership
- Principal residence transferred to joint name with intended beneficiary on death – a portion of accrued capital gain may be taxable on a future disposition - income tax liability may exceed probate tax savings

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Joint Property

Disadvantages

- Joint ownership with one child where there is more than one child can lead to disputes over intention of transferor *Kyle Estate v. Kyle*, 2017 BCCA 329
- Placing a child on title as joint owner can expose the transferor to the child's creditors, including family law claims *Barber v. Magee*, 2017 ONCA 558
- As rebutting a presumption of resulting trust depends on evidence of the intention of the transferor, a written declaration of intention is recommended for all jointly owned property
- To avoid tax and creditor issues, transferee may complete a declaration of bare trust in favour of transferor while transferor is living

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Beneficiary Designations

- Beneficiary designations of RRSP's, TFSA's, life insurance and pension plan benefits avoids EAT
- Where beneficiaries designated in the plan document or the owner's Will, proceeds are paid directly to beneficiary outside the estate
- Designations in a Will override prior dated beneficiary designations made directly in plan documents or prior wills
- Caution – beneficiary designations in a Will speak only to those plans owned at the date of the Will

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Beneficiary Designations

- Tax mismatch: Income tax is payable on death in respect of an RRSP (unless a surviving spouse transfers proceeds to his or her own RRSP)
- estate is liable for the tax, but proceeds paid under a designation are paid directly to the beneficiary
- Address in the Will, how the tax on the RRSP subject to a beneficiary designation is to be paid
- Properly drafted designations made in a Will can attach trust provisions to the designation where the beneficiaries are minors or trusts are desired

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Alter Ego and Joint Partner Trusts

- For persons aged 65 and over, consider using alter ego trusts and/or joint partner trusts as another or alternative vehicle to multiple Wills to avoid EAT
- Assets are transferred to the alter ego or joint partner trust (for spouses) on a tax neutral basis at the adjusted cost base
- Typically the settlor/transferor acts as the sole trustee during his or her lifetime or unless he or she becomes incapable of acting

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Alter Ego and Joint Partner Trusts

- Requirements for alter ego trust are set out in subsections 73(1.01) and (1.02) of the ITA
- Settlor must be resident in Canada and at least 65 years of age
- Trust must be created after 1999
- Settlor/transferor must be entitled to receive all income during the settlor's lifetime

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Alter Ego and Joint Partner Trusts

- No person other than the settlor can be entitled to receive capital during the settlor's lifetime
- Requirements for joint partner trust are generally the same as for alter ego trust, except:
- Settlor and settlor's spouse must be entitled to receive all income during their lifetimes
- Alter ego and joint partner trusts also serve as a useful substitute decision making instrument in the event the settlor/transferor becomes mentally incapable (instead of a power of attorney)

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Alter Ego and Joint Partner Trusts

- Generally seamless for principal residences and other non-income producing real property
- Principal residence exemption is preserved
- A T-3 Trust Information and Income Tax Return must be filed each year, and all income and capital gain is allocated to the settlor/transferor for tax purposes and included in his or her personal T-1 income tax return

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Alter Ego and Joint Partner Trusts

- Settlor/transferor can reserve a power of appointment over the trust assets so that the beneficiaries named on death of the settlor can be changed at will
- On the death of the settlor/transferor, there is a deemed realization of all capital property in the trust at fair market value, similar to the deemed disposition of capital property that occurs on the death of an individual
- Tax is payable by the trust on the capital gain accrued since the date of acquisition of the trust property by the settlor (or the trust, if acquired by the trust)

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Alter Ego and Joint Partner Trusts

- Potential draw back: tax on accumulated income is imposed at the top marginal rate, so that the availability of the graduated tax rate on the potential capital gain on death is not available
- If trusts for beneficiaries are established after the settlor's death, there is no 3 year graduated rate estate tax advantage that is available to trusts established under a Will
- Careful drafting is required if the settlor intends to make charitable gifts on death in order to secure the benefit of the charitable tax credit on death

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Alter Ego and Joint Partner Trusts

Substitute Decision Making

- As an alternative to reliance on powers of attorney ("POA") for incapacity, the well crafted alter ego trust can provide a structure that continues seamlessly if the settlor becomes incapacitated
- POA expires on death, whereas a trust does not
- Trust typically appoints substitute trustees if the settlor /transferor/trustee becomes mentally incapable
- Trust typically provides detailed powers to manage property
- Trust provides more flexibility in tailoring trustee's powers than the typical POA provides

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Powers of Appointment

- Special and general powers of appointment may be useful in avoiding EAT: where property is given on trust subject to a right for the life tenant to appoint the property on his or her death
- Exercise of special powers of appointment under a Will are not subject to EAT
- Exercise of a general power of appointment under a Will will be subject to EAT based on the value of the assets subject to the appointment
- Consider including general powers of appointment in the non probate will in order to avoid EAT

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Bare Trust Arrangements

- Legal title to property may be transferred to a bare trustee private corporation coupled with a bare trust declaration by the corporation
- beneficial ownership is retained by the individual legal owner of the property which has been transferred to the bare nominee corporation
- On death of the individual, legal title does not have to be changed and beneficial ownership may be transferred without probate

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Bare Trust Arrangements

- Caution - Value of assets held in bare trust must be included in the value of the estate for probate tax purposes if there is only one will and probate is needed for any other asset(s)
- May be used for eg. : for investment accounts, bank accounts, art, vehicles and real estate
- Bare trust should be coupled with a non probate will for private company shares specifically including those shares held on bare trust

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Quebec Probate

- If there are assets in Quebec, consider planning to probate the Will in Quebec for a nominal filing fee
- Because the transfer on death of Ontario situs real property generally requires probate in Ontario, a separate Will is prepared to deal with the disposition on death of the Ontario real estate only
- Consider transferring Ontario real property to a bare trustee/nominee company and preparing a special Ontario will to dispose only of the assets held by the bare trustee/nominee company

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Questions?

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