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Changes for Ontario's Estate Administration Tax

On January 1, 2013, a new audit and reassessment regime went into effect for Ontario's Estate Administration Tax (EAT). Regulations under the EAT went into effect on January 1, 2015. This article provides some background on the EAT, discusses the changes that occurred and how life insurance products can help people deal with the new regime.

Background

When a person dies, whether they have a will or not, someone has to administer their estate. That person (or institution) is the estate representative. An estate representative used to be called an executor when the deceased left a will, and an administrator when the deceased died without a will. The estate representative gets their authority to deal with the estate's property from the Ontario Superior Court of Justice, by obtaining a Certificate of Appointment of Estate Trustee (formerly letters probate). The Certificate proves that the estate representative has the authority to deal with the deceased's property.

Without a Certificate, banks and other financial institutions may not let the estate representative deal with the deceased's financial assets unless the amounts involved are low. Those who owed the deceased money may be uncomfortable paying (not because they wouldn't want to pay, but because the estate representative wouldn't have the legal authority to give them a release for paying the debt). Other circumstances may make a Certificate necessary, but the point is that the Certificate lets everyone know that they are dealing with the right person.

Part of the process for obtaining a Certificate is to pay the provincial government a tax. In Ontario, the tax used to be called a probate fee, but is now called an estate administration tax (EAT). Under the pre-2013 regime, staff at the local courthouse assessed the tax when the estate representative applied for the Certificate. They based their assessment on an affidavit the estate representative filed with the Court, listing the property that the deceased owned at death and its value. Under that system, there was little that anyone did to verify that the affidavit was complete or accurate.

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Ontario's money problem

Ontario has a large budget deficit, and is trying to balance its budget. While expenditure reductions help, it also helps when the province collects all the tax revenue to which it's entitled.

At least one commentator has suggested that the EAT does not generate as much revenue as expected, if judged solely from the magnitude of the 1992 EAT rate increase.[1] That rate increase tripled Ontario's EAT rates and made them among the highest in the country at the time: $5 per $1,000 of estate assets to a value of $50,000, and $15 per $1,000 of estate assets over $50,000.[2] Currently, only Nova Scotia's tax rates are higher.[3] Rates in most of the other provinces range from $3 to over $7 per $1,000 of estate assets. Alberta's estate administration tax is the lowest in the country, at a maximum $525.[4] On a $1 million estate, that's $14,500 in Ontario versus $3,000 to $6,000 in other provinces.

Those high rates may be influencing people's behaviour, and may account for some of the "missing" revenue. When tax rates are low, people tend not to worry about avoiding taxes. But as rates rise, people have an incentive to spend the time, effort and money to avoid a tax if they legitimately can.

On the other hand, the notes to the 2011 Ontario budget suggest that the government believes that it has a compliance problem with the EAT:

> The government will propose amendments to the *Estate Administration Tax Act, 1998* to enhance compliance by integrating the administration of this tax with audit and verification functions at the Ministry of Revenue, starting January 1, 2013.[5]

Whatever the reasons for the shortfall in EAT revenues, Ontario has decided to act. Before discussing the changes to the rules, though, let's revisit a few strategies for legitimately avoiding the EAT.

Strategies for legitimately avoiding the EAT

You can structure your affairs in ways that are neither abusive nor illegal, but which allow your estate to pay less in EAT. Here are some of those strategies.

Joint ownership with right of survivorship
At death, the deceased's share of the jointly owned asset moves directly and immediately to the surviving joint owner by operation of law. It does not go through the estate and is therefore not counted in determining EAT. Joint ownership also helps an adult child manage an elderly parent's property, but carries some risks:

- There may be capital gains tax due when ownership is transferred.
- If the child's marriage breaks down, they may have to include their share of the jointly owned property as an asset subject to division with their former spouse.
- The property could be exposed to claims of the child's creditors. The child's interest in the jointly owned asset could be seized and sold to satisfy the child's judgment debts.
- The parent loses the legal right to exclusively control their property.
- When the parent dies, there may be fights over who actually gets the jointly owned property.

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[1] Barry S. Corbin, "Estate Administration Tax – The Nightmare Begins", Deadbeat – Trusts and Estates Section Newsletter, Ontario Bar Association, May 2011, Vol. 29, No. 4, http://www.oba.org/En/tru/newsletter_en/v29n4.aspx.

[2] Ambie K. Edgar-Chana and Lindsay Ann Histrop, Cassels Brock & Blackwell, "Taxed to Death: Heightened Audit for Ontario Estate Administration Tax", November 4, 2011, http://www.casselsbrock.com/CBNewsletter/Taxed_to_Death_Heightened_Audit_for_Ontario_Estate_Administration_Tax.

[3] $15,778.45 on a $1 million estate. Rates from the Probate Act, Chapter 31 of the 2000 Act (Nova Scotia), http://nslegislature.ca/legc/statutes/probate.pdf.

[4] John Dow, "How to Reduce Probate Fees", Strategy, Wills and Estates July 21, 2010, http://www.sbpartners.ca/blog/2010/07/how-to-reduce-probate-fees.

[5] "2011 Ontario Budget: Chapter III: Tax and Pension Systems for Ontario's Future", http://www.fin.gov.on.ca/en/budget/ontariobudgets/2011/ch3.html#c3_secA_EAT.

- Was the parent using joint ownership only to let the child manage the account for the parent's benefit, and to receive the property only as a trustee for all the estate beneficiaries? If so, other estate beneficiaries could reasonably expect to share in a distribution of the jointly owned property. Or did the parent really intend for all the property to go to the one child at the parent's death? The Supreme Court of Canada ruled on this issue in 2007,[6] but joint ownership still carries the risk of expensive misunderstandings.

Living trusts
You can transfer ownership of your property to a trustee who maintains the property for your benefit, then transfers it to your heirs at death (according to language in the trust document). Because you part with ownership of the property when you transfer it to the trust, you don't own the property at death, it does not form part of your estate, and it does not attract EAT.

A trust also allows the trustee to manage your property if you become incapable of managing it while still alive. Using a trust provides more certainty than joint ownership, but there is a cost to creating the trust, and it also requires you to surrender some control over the assets put into the trust. Further, if an institutional trustee is needed, there will be ongoing fees, and there may be capital gains tax consequences when the money is moved into trust, depending on the terms of the trust.[7]

Life insurance products, including segregated funds
When an insured person dies, Ontario's Insurance Act requires the life insurance company to "pay the insurance money to the person entitled thereto".[8] That requirement means that proceeds of insurance go directly to the beneficiary, do not pass through the deceased's estate, and do not attract EAT. This includes the death benefit from a segregated fund.

There is no equivalent wording in any legislation governing non-insurance company financial institutions, including banks and mutual funds. Those institutions may let the account owner designate a beneficiary to receive funds at death, but that designation can't override a contrary provision in the account owner's will or under the intestate succession laws.[9]

As a result, a non-insurance company financial institution will not disburse funds without a Certificate, except for modest amounts. Even then, the institution will require an indemnity from the recipient. The indemnity will cover the risk of someone else showing up with a will and Certificate proving that they were entitled to the funds the institution just paid out.

An example may help to make this clear. If a person's will says that all their property is to go equally to their three children, a mutual fund will be treated as part of that property, even if the mutual fund beneficiary designation names only one of the children to receive the money in the fund. But if the beneficiary designation to a life insurance policy names only one of the children, the insurance proceeds will be paid to that one child even if the will says that all the deceased's property must be split equally among the three children. The money in the mutual fund will be treated as part of the deceased's estate, while the insurance money will not.

Moving financial assets into segregated funds may generate costs like market value adjustments or withdrawal fees and capital gains tax. Unlike the case with joint ownership and trusts, a segregated fund owner retains the same rights of ownership and control over their money as they would have for a non- insurance company financial asset.

[6] *Pecore v. Pecore*, [2007] 1 S.C.R. 795, (2007), 279 D.L.R. (4th) 513, (2007), 37 R.F.L. (6th) 237, (2007), 224 O.A.C. 330, 2007 SCC 17 (CanLII).
[7] The Income Tax Act allows tax free transfers of property into alter ego and joint partner trusts. Not all trusts receive this beneficial tax treatment.
[8] Ontario Insurance Act, R.S.O. 1990, c. I.8, subsection 203(1).
[9] When someone dies without a will, or if their will is later ruled invalid, that person is said to have died intestate. In the absence of formal instructions that would have been found in their will had they left one, their estate is distributed according to rules set out in provincial and territorial law. In Ontario, the rules are set out in Part II of the Succession Law Reform Act, R.S.O. 1990, c. S.26.

The strategies discussed above can provide benefits in addition to estate planning and can reduce the amount of EAT due. They can also make estate planning easier by providing funds quickly and efficiently to beneficiaries. Each strategy must be used properly, though, to avoid problems, and anyone contemplating the use of these strategies must obtain appropriate tax and legal advice.

The new rules

The changes to the EAT went into effect on January 1, 2013. But the regulations providing detailed descriptions of the information required under the EAT, and the forms needed to disclose that information, were not released until December 23, 2014, and the regulations did not become law until January 1, 2015. Here is a summary of the changes that the Act and Regulation have made to the EAT:

- Staff at the local courthouse will no longer collect the EAT. The Minister of Revenue will become responsible for collecting the tax. Anyone applying for a Certificate will have to complete and submit an Estate Information Return (Return) to the Ontario Ministry of Finance within 90 days of a Certificate being issued. If the estate representative discovers an error in their return, they have 30 days to file an amended return with the Ministry.
- On the Return estate representatives will need to provide detailed information about themselves, the deceased, and any property the deceased owned at death that is subject to EAT.
- The required information will include:
  - The deceased's name, address and dates of birth and death.
  - A value and description for all assets subject to EAT, including personal property, real estate and financial assets (including bank accounts and investments).
    - **Real estate.** The estate representative will have to disclose the address, assessment roll and property identifier numbers for any real estate the deceased owned at death, whether personally or in trust. The value of the property, minus encumbrances, must also be declared. If the deceased held the property as a tenant-in-common their percentage ownership must be disclosed.
    - **Bank accounts.** The estate representative will have to disclose all the account numbers, and the names and addresses of all the financial institutions where the deceased had a bank account, as well as the value of those accounts at death and the percentage of the account values that the deceased owned.
    - **Investments.** The Return requires the name of the issuer, number of units, type and details of the instrument or account number. The Return also requires the name, address and telephone number for the broker or agent, as well as the value of the investment on the date of death and the percentage of the investment that the deceased owned.
    - **Personal property.** All personal property, the values for that property, and the deceased's percentage ownership interest in that property, must be disclosed on the Return. The Return specifically requires the estate representative to disclose a vehicle's vehicle identification number or hull number. There is no guidance on how exacting a description of personal property is required, but the Return says, "[I]nclude all other property not listed in previous sections, e.g., business interests, copyrights, patents, trademarks, household contents, art, jewelry, loans receivable, etc."
- The Minister of Revenue may:
  - audit and inspect to ensure compliance with the EAT.[10]
  - assess or reassess an estate for tax payable
    - within four years after the day the tax became payable,[11] or
    - at any time if an estate representative has
      - failed to provide information in a timely way,[12] or
      - made a misrepresentation due to neglect, carelessness, or willful default,[13] or
      - committed fraud in supplying required information.[14]

[10] Better Tomorrow for Ontario Act (Budget Measures), S.O. 2011, Schedule 14, subsection 4.7(1).
[11] Ibid, subsection 4.5(1).
[12] Ibid, note 8, paragraph 4.5(2)(a), referencing subsection 4.1(3).
[13] Ibid, note 8, paragraph 4.5(2)(b).
[14] Ibid, note 8, subsection 4.5(2).

- An estate representative can object to an assessment within six months, provided they give specific details related to the assets, issues and reasons for the objection.[15]
- It will be an offence to make or assist in making a false or misleading statement, or omit relevant facts when applying for a Certificate. The fine can range from a minimum of $1,000 to a maximum of twice the EAT payable.[16]
- Nothing in the legislation affects any of the strategies currently used to avoid the EAT by passing assets to heirs outside the estate.
- EAT rates will not change.

Significantly, given the penalties and length of time that an estate remains subject to audit and reassessment, an estate representative won't get a clearance certificate after having paid the EAT. A clearance certificate is part of the income tax process. When the estate representative pays the estate's and deceased's income taxes, the Canada Revenue Agency (CRA) gives the estate representative a clearance certificate to show that the CRA is satisfied that all income taxes have been paid.

Without a clearance certificate, the estate representative cannot distribute the balance of the estate to the beneficiaries, because the CRA could assert that it is owed additional taxes. In that case, the estate representative would be personally responsible for paying the taxes.

The new EAT legislation does say that "tax is payable by the estate representative in his, her or its representative capacity only." But that assurance is not the same as a commitment to not pursue taxes after giving a clearance certificate. Further, it's not clear just what protection, if any, is afforded by the assertion that the estate representative will be liable only as a representative.

What do the changes mean for advisors and clients?

The changes to the EAT have increased an estate representative's risk of having to pay additional EAT years after they thought their job was done. In the process, they have made the life insurance industry's products more valuable in estate planning than before. The existing reason for using life insurance products to pass assets outside the estate – to reduce EAT – still applies. But the new rules have given estate representatives another reason for passing assets outside the estate: to eliminate or reduce an estate representative's potential liability should the province audit and reassess them.

Assuming that an estate representative discloses all the estate assets, the province could still challenge the value assigned to those assets. By converting physical assets to financial assets where appropriate, and by converting non-insurance company accounts to insurance policies and segregated funds, an individual can reduce the amount of money that will be paid in EAT and reduce the estate representative's potential exposure on audit. Of course, this strategy will not help if the estate representative omits to report estate assets subject to EAT or undervalues those assets.

Conclusion

Probate fees were originally introduced as a means to offset the government's cost of administering the probate process. Long ago they ceased functioning as a means for offsetting expenses and became a way for the government to generate revenue. Ontario's decision to audit the EAT is consistent with that change in purpose.

Still, there are many ways to avoid the tax and reduce the risk for the estate representative if you take steps in advance. Life insurance products are an effective way to pass wealth outside of an estate, to reduce exposure to the EAT and reduce the estate representative's exposure if they are audited.

[15] Ibid, note 8, section 4.6, incorporating by reference sections 24 to 30 of the Ontario Retail Sales Tax Act, R.S.O. 1990, Chapter R.31.
[16] Better Tomorrow for Ontario Act (Budget Measures), S.O. 2011, Schedule 14, section 5.1.

Every effort has been made to ensure the accuracy and currency of the information provided. However, any examples presented in this article are for illustration purposes only. No one should act upon these examples or information without a thorough examination of the tax and legal situation with their own professional advisors after the facts of the specific case are considered.

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