

## Wills, Estates & Trusts

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### Executors Beware: Important changes to the administration of Ontario probate tax are coming

#### Ontario Budget 2011 Amendments

The 2011 Ontario budget, delivered by Finance Minister Dwight Duncan on March 29, 2011, contained relatively few tax measures and was generally overlooked. One budget proposal, however, will significantly alter the way in which the Ontario Estate Administration Tax (“EAT”) is assessed and collected. The amendments to the *Ontario Estate Administration Tax Act, 1998* (the “EAT Act”) announced in the 2011 Budget received Royal Assent on May 12, 2011. Although these amendments will not generally take effect before January 1, 2013, estate trustees and their advisors should be aware of the new tax audit and collection regime and the potentially severe consequences for non-compliance.

#### Changes in EAT Administration

The EAT (formerly referred to as “probate tax”) is currently administered by the Ontario Attorney General’s office as part of the process through which the estate administrator is appointed. In very general terms, an estate trustee typically seeks a certificate of appointment of estate trustee (often referred to as “letters probate” or “certificate of appointment”) from the Ontario Superior Court of Justice as evidence of the trustee’s authority to deal with the estate’s assets. Without a certificate of appointment, the estate trustee will not be able to, for example, transfer real estate in Ontario, realize on insurance policies or have access to bank accounts and investments to pay out the estate’s funds to creditors and beneficiaries.

EAT must be paid on the value of the assets governed by the will in respect of which the certificate of appointment is sought. Where a deceased person has only one will (as is commonly the case) then all assets owned solely by that person, or to which he or she is beneficially entitled on death, must be declared as estate assets on which EAT is payable. In many cases, jointly owned assets will pass by

rights of survivorship to the surviving owners, thereby bypassing the will and the EAT Act. There are exceptions, however, and it is expected that the Ministry of Revenue will be scrutinizing these kinds of assets very carefully once the amendments take effect. Other types of assets, such as private company shares which can be transferred without a certificate of appointment, may be dealt with in a separate will on which EAT is not payable.

The EAT Act provides that EAT is payable on the issuance of the certificate of appointment by the estate trustee in his or her representative capacity, although typically the EAT is paid out of the estate’s funds when the application is made. The application for a certificate of appointment currently requires the applicant (the estate trustee) to provide basic identifying information about the deceased person and to report the total value of all the personal property and the net value of real estate held by the estate.

The combined value of the estate’s reported property is the tax base on which EAT payable by the estate is computed. EAT is applied at the rate of \$250 on the first \$50,000 of estate assets and \$15 per \$1,000 of estate assets thereafter. Encumbrances on real property such as mortgages are deducted from the value of the property but other assets must be reported at their gross values as at the date of death. An estate valued at \$1,000,000 would therefore have an EAT liability of \$14,500.

The current regime requires estate trustees to swear an affidavit as part of the application process, confirming, among other things, that the reported value of the estate is true. It is a criminal offence to knowingly swear a false affidavit. Although it is expected that estate trustees will continue to be required to swear an affidavit to confirm the value of the estate, there is currently no requirement for supporting documentation to back up the asset value reported. Therefore, it is likely that asset values are being conservatively estimated in most cases, and significantly

underestimated in some cases. Moreover, a number of estate planning techniques, such as investing in insurance with a named beneficiary or using multiple wills, can reduce the amount of EAT payable by the estate by excluding certain assets from the EAT base.

Although the EAT Act has always permitted the Minister of Finance to commence court proceedings to recover any EAT payable, it did not (prior to the Budget 2011 amendments) impose the type of audit, assessment and appeal regime typically found in a provincial taxing statute such as the Ontario *Retail Sales Tax Act* or a federal statute such as the *Income Tax Act*.

In an effort to “enhance compliance” with the EAT Act, the 2011 Budget amendments have shifted responsibility for collecting EAT away from the Attorney General and instead integrated that responsibility with the existing tax audit and verification functions at the Ministry of Revenue. In general terms, the amendments impose the compliance regime formerly applicable to Ontario retail sales tax (prior to Harmonization with federal GST) by incorporating certain provisions of the *Retail Sales Tax Act* by reference into the EAT Act and by introducing several new provisions. The effect of the amendments is to introduce a formal tax audit and collection system, including an assessment, objection and appeal regime similar to that found in the federal *Income Tax Act*, to the estate administration system in Ontario.

## Amendments Executors Need to Know About

The most significant of the amendments to the EAT Act are as follows:

- Applications for certificates of appointment will have to be made on a prescribed information return that, at a minimum, will require the applicant to provide detailed information about the deceased person. The new form and the time period in which it must be submitted have not yet been announced but is expected that an applicant will have to provide a detailed inventory of the estate’s property and a declaration of the value of each asset.

- Failure to provide the required information, intentionally providing false or misleading information or assisting in the provision of false or misleading information will be an offence punishable by a fine ranging from \$1000 to twice the value of the EAT payable and/or up to 2 years imprisonment. Not knowing that a statement or omission was false or misleading will be a defence to the offence, provided the person charged could not have known the statement or omission was false or misleading on the exercise of reasonable diligence.
- The Minister of Revenue will authorize EAT inspectors and give them very broad powers of audit and inspection to administer the EAT. Inspectors will also have the authority to demand that *any person*, not just the estate trustee, provide information, documents or electronic records related to the administration of the EAT Act.
- Estate trustees will be required to keep records and accounts containing information related to the assessment of EAT.
- The Minister of Revenue may issue an assessment or reassessment of EAT, usually within 4 years of the date the tax became payable (i.e., on application for the certificate of appointment). This limitation period will be extended indefinitely if no information return is filed or if a misrepresentation attributable to neglect, carelessness, wilful default or fraud is made with respect to information provided regarding the estate.

This provision could allow the government to issue a reassessment of additional EAT payable long after estate assets are distributed to the beneficiaries by asserting that there was a negligent or willful misrepresentation about the value of estate assets. It might also permit the government to question the validity of transfers of estate assets to a named beneficiary or surviving spouse and assert that those assets should be subject to EAT.

- The estate representative may object to an assessment or reassessment by filing a notice of objection, within 6

months of the assessment date. The notice of objection must clearly set out the issues, facts and reasons for the objection.

- The government may allow the objection by cancelling the assessment or reassessment, or may vary the amount assessed. If the objection is not allowed, however, further appeals of the assessment or reassessment may be made to the Ontario Superior Court.
- The Minister of Revenue and all Crown employees must maintain confidentiality with respect to information obtained in connection with the EAT Act, subject to limited exceptions related to administration and tax policy.

These new provisions will apply to applications for certificates of appointment made after January 1, 2013 (unless a later date is prescribed).

## Executors Take Care

These amendments provide the government with increased power to assess and collect a significant source of provincial tax revenue and will also significantly increase the record-keeping and compliance burden on estate trustees. Estate Trustees will need to be thorough, at the very early stages, in identifying and locating all assets belonging to the deceased and in keeping records to show the efforts made in this regard.

Estate Trustees will also need to be diligent in obtaining opinions as to the value of real property forming part of an estate, and a formal expert estate valuation of personal effects, collectibles, other valuables and vehicles may now be required to support an application for an estate certificate. As the government could potentially issue a reassessment many years after the estate is distributed by alleging misrepresentation, estate trustees should also ensure that they retain documentation supporting the valuation and other details set out in the information return well after the four year reassessment period has ended.

Disputes with EAT auditors are certain to arise if the government believes that certain estate assets have been

under-valued or if certain estate planning techniques have been employed in order to reduce the EAT payable. While it will be possible to dispute the assessment or reassessment of EAT, it could prove expensive and time-consuming to do so. As with other Ontario taxing statutes, there is no limit in the amended EAT Act on the amount of time the government can take to respond to an objection. Legal and administrative costs incurred in disputing a reassessment issued after the estate has been distributed may be borne by the estate beneficiaries, which may present practical difficulties if the beneficiaries do not agree or are in different jurisdictions. The amendments do, however, also provide estate trustees with some procedural protection by setting out clear objection and appeal rights and ensuring the confidentiality of information collected in the course of EAT administration.

Once the new application and audit procedures are in effect, estate trustees will need to ensure that estate valuations are carefully prepared and objectively supportable. Some estate planning techniques, such as transferring assets into joint ownership before death or implementing *inter vivos* trusts, will likely come under increased scrutiny by EAT auditors. It will be important to ensure that these types of transfers are carefully considered and properly documented to establish that they are legally effective and that the intentions of the deceased person can be substantiated. At the same time, many estate planning opportunities, such as making *inter vivos* gifts or implementing an estate freeze which legitimately reduce the EAT base, should be explored as a means of minimizing the impact of EAT to the estate.

Some advisors have noted that, unlike the federal *Income Tax Act*, the amended EAT Act does not provide a “clearance certificate” mechanism which would permit estate trustees to distribute estate assets without fear of further assessments. The government’s view, as expressed in committee discussions before the amendments were passed, is that clearance certificates are unnecessary because the EAT Act expressly provides that the estate trustee is liable for EAT only in a “representative capacity.”

Although estate trustees should not be held personally liable for EAT assessed after estate assets have been distributed to

beneficiaries, it may be appropriate for executors to seek indemnification from the beneficiaries for any EAT assessed by the Ministry of Revenue after distribution. This may be particularly important if the beneficiaries reside outside of Ontario.

If you need assistance in preparing for the new EAT regime, please contact a member of our Wills, Estates & Trusts Practice.

**Craig Ross** is a member of the firm's Wills, Estates & Trusts Practice.



## Pallett Valo LLP Wills, Estates & Trusts Practice

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We work closely with our clients and their other professional advisors to develop a customized estate plan. We use vehicles like tax-planned trusts and wills to accomplish our client's personal objectives while minimizing adverse tax consequences, including the reduction of probate taxes. We are experienced in the complex issues relating to business succession planning and ongoing wealth transfer. In this way, our clients are better prepared to deal with aging, illness, incapacity and death.

**Lisa Sticht-Maksymec** is a member of the firm's Wills, Estates & Trusts Practice.



Upon incapacity or death, we represent and advise Estate Trustees, beneficiaries, heirs, surviving spouses and other family members. We have unique expertise advising families with disabled beneficiaries. When disputes arise in the administration of an Estate, we provide experienced counsel to assist in their resolution, whether by litigation or other dispute resolution mechanisms.

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