Probate planning

to minimize estate costs

TAX & ESTATE BULLETIN

Probate serves as proof to financial institutions, financial advisors and the land registry office that your will has been certified by the court and that your executor is authorized to represent your estate.

What is probate?

When you die, your will gives legal authority to deal with your estate to your executor (*estate trustee* in Ontario, *liquidator* in Quebec). Although your executor is legally entitled to do so, when the time comes to redeem or transfer certain assets registered in your name (such as investments with financial institutions, publicly traded shares and, in some instances, real estate) probate is usually required. Probate serves as proof to financial institutions, financial advisors and the land registry office that your will has been certified by the court and that your executor is authorized to represent your estate.

This process of obtaining court certification is known as probate. Probate taxes have been in existence since 1358, when they were introduced in England. In Canada, the first legislation dealing with this issue was enacted in 1793. In 1950 the legislation was amended and the tax was designated as a "service fee." Although services provided are identical from province to province (with the exception of Quebec), the cost varies under the laws of each province. A 1998 Supreme Court of Canada decision in the Eurig estate case forced a change in provincial legislation to correct the situation.

This change is retroactive to 1950 and has now reconfirmed probate taxes. (In that case, Mrs. Eurig disputed the probate fee of $5,710 charged on her late husband's estate and successfully argued before the Supreme Court that the fee was actually a tax.)

Some provinces vary the terminology used in the probate process. Ontario now calls the cost of probate an "Estate Administration Tax" while other provinces call the cost of probate a "fee" or a "tax." The actual grant of probate in Ontario is now known as a "Certificate of Appointment of Estate Trustee with a Will." You should be aware of the terminology used in the province in which you live*. In this document we will refer to the cost of obtaining court certification as "probate tax."

*NOTE: The province of Quebec does not require probate for notarial wills.

What property is included when calculating probate tax?

The cost of probate generally is based on the fair market value of all property that you own at the time of your death.

Some assets are excluded from valuation for probate purposes. These include:

- Assets registered in joint names and which, on the death of the first person, automatically pass to the survivor(s) by right of survivorship
- Real estate you own that is located outside the province of residence
- Life insurance and, in most provinces, RRSP/RRIF holdings for which you have named a beneficiary (other than your estate)

Calculating probate taxes

Probate tax rates by province (as at May 1, 2000)*

Alberta	Under $10,000 $10,000 to $249,999 $250,000 and over	$25 fee Progressive to $300 $400 (maximum)
British Columbia	First $10,000 $10,001 to $25,000 $25,001 to $50,000 Over $50,000	No fee $200 0.60% 1.40%
Saskatchewan	All estates	0.70%
Manitoba	First $10,000 Over $10,000	$50 $50 + 0.60%
Ontario	First $50,000 Over $50,000	0.50% 1.50%
Quebec	Notarial wills Holograph/witnessed	No fee Nominal fee
Nova Scotia*	First $10,000 $10,001 to $100,000 Over $100,000	$75 Progressive to $700 $700 + 1.2%
New Brunswick	First $5,000 $5,001 to $20,000 Over $20,000	$25 Progressive to $100 0.50%
Northwest Territories (includes Nunavut)	First $500 $501 to $1,000 Over $1,000	$8 $15 $15 + 0.30%
Newfoundland	All estates	$75 + 0.50%
Prince Edward Island	First $10,000 $10,001 to $100,000 Over $100,000	$50 Progressive to $400 0.40%
Yukon	First $25,000 Over $25,000	No fee $140

* These rates are quoted for use in estimating probate costs. Actual costs of probate may vary minimally when actual detailed tiered rates are used.

As you can see, the cost of probate varies from province to province. As an example, if you have a *probatable estate* (all holdings are included for probate) valued at $625,000, your estate would be charged probate taxes in Prince Edward Island at a different rate than in Ontario, British Columbia or Quebec. A comparison of the calculations illustrates the provincial differences:

Value of estate: $625,000

	Ontario		British Columbia		Prince Edward Island		Quebec (Notarial wills only)
First	$ 50,000	$ 250	$ 50,000	$ 300	$100,000	$ 400	$0
Remaining	$575,000	$ 8,625	$575,000	$ 8,059	$525,000	$ 2,100	$0
Total	$625,000	$ 8,875	$625,000	$8,359	$625,000	$2,500	$0

You can see why reducing probate taxes through the use of various planning techniques is an important part of effective estate planning, especially in Ontario and British Columbia.

Probate tax planning

Multiple Wills

Probate taxes are usually calculated on the value of the *gross estate*. This means that debts (with the exception of mortgages or other claims against real estate) are not deducted when calculating the estate value. This calculation rule can have a big impact on estate assets if there are more debts than assets. For example, if your estate has a gross value of $500,000 and debt of $300,000, and $100,000 of the debt consists of a mortgage, probate taxes would be calculated on $400,000, and not on the $200,000 in assets. If probate is required for any part of your estate, the entire estate value must be used to calculate the cost of probating the will, even if some of the estate assets do not require probate to effect a change of ownership (for example, Canada Savings Bonds worth less than $20,000, or shares in a private company).

The use of multiple wills was validated by the Ontario court decision in the Granovsky estate case. Under this practice, a primary will is used to deal with probatable assets. A secondary will is drawn up to deal with assets that do not require probate. This method requires you to draw up two wills limited to specific property, with an executor named in each. Upon your death, your executor would submit only the primary will for probate, and the probate tax calculation would be based on the assets governed by that specific will. This strategy makes sense for estates of significant value (say, $200,000 or more) where the savings in probate tax would justify the additional time and expense of dealing with more than one will.

If you are considering using the multiple wills strategy, make sure you get legal advice. As of late May 2000, using multiple wills to avoid probate tax has been validated only by the court in Ontario (in Granovsky), and was based on Ontario statutes. Each province has its own statutes that will affect the usefulness of multiple wills in your situation.

If you are using the multiple wills technique, it is important to include a clause in each will that

specifically describes the nature and date of the will being replaced (primary or secondary). It is also critical that your wills are kept up to date because a change in assets can significantly influence your estate plan. If you are not sure whether a specific asset is probatable, it is wise to include that asset in your primary will. If you include a probatable asset in your secondary will in error, that will would require probate. In that instance, it would defeat the objective of multiple wills, namely saving probate taxes.

For more information on wills, please ask for a copy of our Tax & Estate Bulletin entitled *Structuring an Effective Will*.

EXAMPLE

John Russell owned his own private company, a house valued at $250,000 (no mortgage), a bank account with a balance of $2,500 and an investment portfolio valued at $360,000. At the time of his death John's private company shares were worth $525,000. John was a widower, with no dependents.

Using Ontario rates for probate calculations, probate taxes payable would be:

	Single will	Primary will	Secondary will
House	$ 250,000	$ 250,000	–
Bank account	$ 2,500	$ 2,500	–
Investments	$ 360,000	$ 360,000	–
Private shares	$ 525,000	–	$ 525,000
Gross estate	$ 1,137,500	$ 612,500	$ 525,000
Probate calculation			
First $50,000	$ 250	$ 250	No probate
$15 per $1,000 on balance	$ 16,320	$ 8,445	No probate
Total probate tax payable	$ 16,570	$ 8,695	$ 0

In this example, probate costs are reduced by $7,875 when multiple wills are used.

NAMED BENEFICIARIES

The Insurance Act allows for direct payment of the proceeds of an insurance policy on your life to a named beneficiary upon your death. Insurance designations can be made either by naming a beneficiary on the policy, or in your will. As long as there is a named beneficiary (who, in the case of an individual, is still alive at the time you die), the insurance proceeds are excluded from

the value of your estate. In addition to insurance policies, you can name beneficiaries on registered pensions, RRSP and RRIF accounts in most provinces, as allowed by provincial laws.

If you name a beneficiary on an insurance policy, pension, annuity or seg fund and your intended beneficiary dies before you do, unless you have named an alternate beneficiary the value of the designated asset must be included in your estate. It is then subject to probate tax. You can name more than one beneficiary on a plan, in which case the proceeds would be shared equally among all beneficiaries, or paid to the beneficiaries who are alive at the time of your death. Many companies also allow you to name a first choice of beneficiary called *primary* and to also name a beneficiary who will only receive the proceeds if the primary beneficiary predeceases you. The beneficiary in this case is called an *alternate* or *contingent*. If you want more control over the distribution of the proceeds, you can arrange for the proceeds to be paid into your estate and dealt with according to instructions in your will. In that case, the proceeds would be subject to probate tax.

Another option is to set up an insurance trust to receive life insurance proceeds on behalf of your beneficiaries. This type of formal trust is most often created by a declaration in your will, but because the insurance policy pays directly to the trustee you named in your will, and he or she immediately deposits the money into the trust account, the proceeds are not considered to be part of the estate for probate tax purposes. If you are considering using an insurance trust, it is important to discuss the benefits of this option with your legal advisor.

As you can see, although probate planning is important, there are other factors that you should consider in conjunction with naming beneficiaries to minimize or avoid probate tax. These issues include making sure there is enough cash or easily cashable assets in your estate to pay income or capital gains taxes. There are also family law and inheritance issues. The cost of ignoring general estate planning issues may be greater than the probate taxes saved.

Joint Ownership

A commonly used method to avoid probate tax on death is to hold property as joint tenants with right of survivorship (not available in Quebec). Jointly held property passes automatically, by operation of law, to the surviving joint owner or owners and therefore does not form part of the estate and is not subject to probate tax. For more information on this strategy, including potential tax pitfalls, please see our Tax & Estate Bulletin entitled *Joint Accounts*.

Real Estate outside the Province

Real estate outside your province that is owned by you at the time of your death is not subject to probate tax with the rest of your estate assets. However, with the exception of Quebec, the jurisdiction where the real estate is located may impose its own probate taxes on that property. If you have a large estate and live in a province like Ontario or British Columbia where the probate tax rates are high, Alberta may seem like the best place to own property for probate purposes.

GIFTING

You may reduce the value of your probatable estate by making gifts while you are alive. There is no gift tax payable in Canada although there may be income tax consequences.

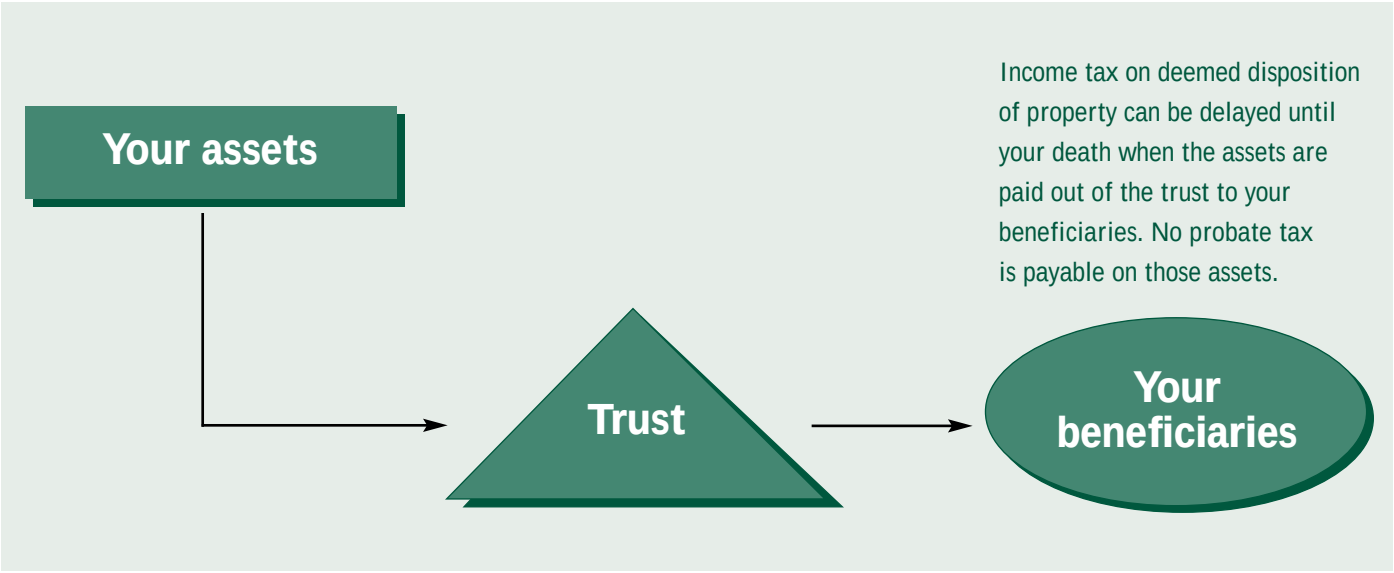
The tax rules state that if you dispose of any property (by selling it or giving it away) and there are no proceeds, or the proceeds are less than the fair market value of the property, you will be deemed to have received an amount equal to the fair market value of the disposed property. This means that if you give away assets, you may have to report a capital gain on the property. If you are considering gifting property, talk to your advisor to make sure you understand the legal and tax implications of this strategy.

Revocable living trusts ("alter ego" and "joint partner")

Generally, when assets are transferred to a trust for estate planning purposes, the change in ownership triggers a taxable *deemed disposition*. This means that for tax purposes the assets are treated as if they were sold by you and then purchased at fair market value by the trust. As a result, any deemed gain realized from the transfer becomes taxable to you.

There are many reasons why you might want to transfer assets to a trust. For example, you may be able to save on probate taxes on these particular assets by changing the registered ownership from your own name. In doing so, the assets are no longer considered to be part of your estate at the time probate tax is calculated. Using a formal trust lets you benefit from the income during your lifetime, but have the assets distributed to other beneficiaries after your death.

Another benefit of using a trust is that it offers a level of confidentiality that you cannot achieve through a will. By law, a will becomes a public document once it is probated. Regardless of your motivation for setting up a trust, you should be aware that the transfer of assets to the trust may trigger an immediate income tax liability to you if there are significant unrealized gains.



Alter Ego Trust

Under certain circumstances outlined in recent draft legislation (December 1999), you can set up a trust to help meet your planning objectives while minimizing the tax implications. The transfer of your assets to an alter ego trust is one strategy that does not necessarily trigger a taxable disposition (unless you, as transferor, make an election to have the disposition take place at fair market value). Upon your death, the assets in the trust are deemed disposed of, and the tax payable is determined at that time. Alter ego trusts must be set up after 1999 by individuals who are at least age 65. The terms of the trust must include the restrictions that you are entitled to receive all of the income from the trust during your lifetime, and that during your lifetime no one else is entitled to receive or have the use of any income or capital of the trust.

Joint Partner Trust

If you want to transfer all of your assets to a trust not just for yourself, but also for your spouse, current tax rules will trigger tax on the transfer of assets. The recently proposed legislation also introduced the concept of a tax-free transfer to a joint partner trust. As with the alter ego trust, there will be no taxable disposition unless you make an election to transfer the assets at fair market value and trigger the disposition. On the death of the survivor of you or your spouse, the assets in the trust will be deemed to be disposed of at fair market value, and tax will be payable at that time from assets within your estate.

The establishment of a joint partner trust requires that it be set up after 1999 by individuals who are at least age 65 and that you and your spouse (including common law and, in 2001, same-sex partner) be entitled to receive all of the income from the trust until the survivor of you or your spouse, common law or same-sex partner dies. Also, during the time the trust is in effect, no one else is entitled to receive or have access to any income or capital of the trust.

Once assets have been placed in either an alter ego or joint spousal trust, those assets no longer form part of your estate, and therefore will not be subject to probate tax. If you are considering these kinds of trusts, it is essential that you obtain legal advice.

Summary

Probate planning is an important part of estate planning, but it should always be considered in conjunction with effective tax planning and other general estate planning priorities. Talk to your advisor to make sure your estate plan satisfies all your financial and personal concerns.

Have a tax or estate planning question?
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