Manulife Financial

Tax Topics

THE TAX AND ESTATE PLANNING GROUP

Probate Fees: Valuing the Assets of the Estate

This Tax Topic is the second of a two part series on probate fees. It will examine the assets that are included in a determination of the value of the estate for probate fee purposes. A discussion on planning opportunities to avoid probate fees is also reviewed. The discussion in this Tax Topic is based on requirements found in Ontario Legislation. The issues surrounding valuation of assets of the estate are provincial specific. In general terms, the issues addressed in this Tax Topic can apply to other provinces with the exception of Quebec. Legislation in Ontario however will be the primary focus of this Tax Topic.

What assets are included to determine probate fees?

There is a misconception that a ready-made list exists, which sets out and defines property that must be valued and included for the purposes of determining probate fees. Each province has provincial legislation, which provides how the value of the estate will be arrived at and how probate fees will be determined. For instance, in British Columbia the Ministry of the Attorney General has produced a guideline to assessing probate fees. It is important to be aware of other provincial requirements where an individual has property located in more than one jurisdiction. Probate fees will be levied in each province where property exists. (See the First Part of this Tax Topic "From Fees to Tax: Probate is Alive and Well"). In some provinces, probate fees are not in issue; for instance in Alberta probate fees are capped and in Quebec a nominal fee is administered for the processing of a notorial copy of the will. Therefore planning opportunities will vary from province to province, depending on how fees are levied in that particular jurisdiction.

In Saskatchewan, all assets must be included on the application form for probate. This is regardless of whether the asset flows through the estate. For instance, a life insurance policy with a designated beneficiary must still be disclosed on the form even though the insurance proceeds that will be paid out to a designated beneficiary at death do not actually form part of the estate.

By way of an example as to what assets are included in the calculation, Ontario legislation will be examined. In Ontario, two pieces of legislation must be read in conjunction with one another to determine the value of the estate for probate fee purposes. The Estate Administration Tax Act, S.O. 1998, c. 34, at s. 2 confirms that the estate must pay a tax (referred to as "Estate Administrative Tax" (EAT)) immediately upon the issuance of an estate certificate. The estate certificate includes a grant of probate. Under the definition provisions of the Act, the "value of the estate" for the purposes of determining the amount of tax to be paid refers to s. 32 of the Estates Act, R.S.O. 1990, c. E. 21, as amended by 1994, c. 27; 1997, c.23; 1998, c.34. This definition section also includes "all the property that belonged to the deceased person at the time of his or her death less the actual value of any encumbrance on real property that is included in the property of the deceased person".

Section 32(1) of the Estates Act, requires the person applying for a grant of letters probate or administration to provide a true statement of the total value (verified by oath or affirmation of the applicant) of "all" the property that belonged to the deceased at the time of his or her death. The Estates Act was amended in 1998, and the former s. 53 repealed. The former section 53 indicated that fees were to be based on the value of the "whole estate". There is nothing to replace the meaning of the phrase "whole estate" now that section 53 has been repealed. The word "all" in s. 32(1) does not provide further clarification or is not defined with any detail. S. 32(2) does confer an obligation on the applicant to provide an evaluation of subsequently discovered property within six months after probate is granted. Court application for probate will direct that the value of the estate not include insurance payable to a named beneficiary, assets held jointly and passing by survivorship, or real estate outside of Ontario.

Because of the provisions contained in s. 32(1) of the Act, requiring that "all" of the property be included in the application, it is somewhat difficult to reconcile this section with s. 32(3) of the Act. Section 32(3) of the Act allows the applicant to limit the property of the deceased to be included in the application. This obviously is desired because only those assets that would be the subject of the application would be included in the value and thus the probate fee would be less than if all of the assets of the estate were valued. At first glance, this would appear to allow the applicant some discretion as to what assets may be included on the application for the purposes of valuation. However, picking and choosing assets for the purpose of avoiding probate fees will not succeed. Limiting the assets to save on probate fees was not justifiable in the decision in Re Sadler Estate, (1991) 114 N.B.R. (2d) 262 and 41 E.T.R. 222.

Excluding those assets that do not require an estate certificate or letters of administration appear to properly invoke the limits allowed in s. 32(3) of the Act. A second will can be created dealing with the distribution of the assets that would not be the subject of an application for a probate grant. In this instance, EAT would not be levied. A second will with assets that will not require probate appear to substantiate to the court that those assets should be excluded as was the case in Estate of Philip Granovsky**,** (1998) 156 D.L.R. (4th) 557, 53 O.T.C. 375, 21 E.T.R. (2d) 25. While there is still not a great deal of case law in relation to multiple wills, there appears to be a planning opportunity available to have multiple wills drafted to avoid probate being levied on all assets of the estate. Caution should however be taken when drafting multiple wills to ensure that one will does not revoke the other. It should be noted the Probate Act of Nova Scotia does not permit the use of multiple wills nor is this type of planning permitted in Manitoba. B.C. may also be a jurisdiction where it is questionable whether multiple wills can be used, however the B.C. courts have not yet been able to clarify this issue.

How is the value of the asset determined?

An estate is comprised of a variety of assets, which must be valued to determine the value of "all of the estate" for the purposes of administration in Ontario. Generally, fair market value is used in the calculation. Assets are determined on a gross not a net value, although there is the exception of real estate. Depending upon the type of asset, valuation can be complicated. A full discussion on different methods to value assets is beyond the scope of this Tax Topic, but in most instances the services of a professional valuator with expertise in a particular area will assist in obtaining a value.

The value of assets may or may not be difficult to determine. For instance most estates contain real property. Real property refers to real estate. For the most part, the value of real estate can be determined either by agreement of the parties or through obtaining an appraisal. Parties may look to the current market conditions to similar properties in the same vicinity in determining value. As well, an appraisal from a certified property appraiser can be

used to determine the current fair market value of the property. Determining the fair market value of real estate may become difficult where there are certain impairments to the right of title to the property. For instance, easements, or a right of way may affect the title to the property and therefore the value. Zoning may also have implications on the value of the property. As well, environmental issues and erosion where property is close to water may affect the value of the property.

Chattels refer to personal property that is moveable. This is personal property that is not connected to real property. Chattels can include such things as cars, jewelry, or furnishings. Often individuals have difficulty in attaching a fair market value to such items that are second hand. In this instance, an auctioneer or an appraiser can provide a fair market value for these items. Where there are specialty items such as antiques or jewelry an appraiser with expertise in the particular area should be sought.

The above are examples of tangible assets that actually exist. For the most part, it is easier to attain the value of tangible assets as opposed to intangible assets. Intangible assets describe a right rather than a physical object. Intangible property includes goodwill, trademarks, copyrights or franchises. Reference to "intangible property" is a term used mainly for taxation purposes. Intangible property means having no intrinsic and marketable value. With intangible property there is evidence of value as for example a promissory note, a stock or a bond. Intangible property also includes claims and interests. To determine the value of an intangible asset, reference to contracts or agreements in writing may provide particulars as to how the right or interest will be valued. In the event such documentation or agreements do not exist or are silent on the issue of value, it may be necessary to retain an expert to provide an opinion as to the fair market value of the intangible property.

In some instances, intangible assets may not need to be included in determining the value of the estate for probate fee purposes. For instance, shares in a private corporation are an intangible asset that may be excluded. Pursuant to provisions contained within s. 67(2) of the Ontario Business Corporation Act, R.S.O. 1990, c. B. 16, probate appears not to be required for shares to be transferred. A corporation may treat the executor, administrator, heir or legal representative of heirs as a registered security holder. Pursuant to s. 76(1) of the Canadian Business Corporation Act, R.S.C. 1985, C-44, shares can be transferred without probate in limited situations. (See the first Tax Topic: "From Fees to Tax: Probate is Alive and Well".) The law however in this area is not entirely clear. If the provisions within the legislation cannot be relied upon and probate is required, a certified business valuator would be required to obtain a value. That value in most instances would be determined by the greater of the value of tangible assets versus employing a capitalized earnings method. The value of life insurance would not be included in the valuation generally because the valuation occurs from the perspective of the value immediately before death.

The situs of the intangible asset may be relevant to determining whether probate fees should apply. In Re Bloom, [2004] B.C.S.C. 70, shares, bonds and debentures were determined to fall outside of probate fees because the securities were purchased in Toronto and maintained there.

How to plan to avoid probate fees

While probate tax is inevitable in relation to the value of some assets, careful planning can reduce significantly the amount of fees to be paid. Planning techniques are used to remove assets from the value of the estate. Probate may be avoided on the value of property that passes to the intended beneficiary without flowing through the estate. There are planning opportunities available to avoid the application of probate. It must be remembered that planning should not interfere ultimately with the testator's wishes. As well, planning techniques to avoid EAT should not jeopardize the interest in the assets of the estate. The

following are techniques and where applicable notations regarding issues of concern when planning to limit probate fees: (note assets in provincial legislation in Ontario are referred to below)

1) The existence of a will unless found to be invalid, may avoid an intestacy. Where an individual dies intestate, probate fees may automatically apply. Therefore, having a will drafted and executed at least avoids the possibility of triggering probate fees.

2) Owning assets in joint tenancy with a spouse, child or family member is one way to avoid probate. Under joint tenancy, the interest of the deceased automatically reverts to the survivor(s) upon death and therefore the transfer can occur outside of the estate without the necessity of probate. However, careful consideration should be given to holding title in this manner. One issue is that there is a loss of control over the asset once it is held jointly. For instance, consider naming a child jointly on a parent's bank account to avoid probate. Assets held in a joint bank account and passing by survivorship flow outside of the estate and are not subject to probate fees. However, with this type of arrangement both the parent and child has access to funds, which may not be a desired outcome.

   It is not uncommon for an elderly person to transfer assets into joint ownership so the child can assist in administering the parent's financial affairs as well as avoid the issue of probate upon death. After the death of the parent, the question arises as to whether the transfer was intended to effect a gift or whether it was simply for convenience. In two recent Supreme Court of Canada cases, Pecore v. Pecore 2007, SCC 17, and Madsen Estate v. Saylor, 2007, SCC 18, the Court had to consider the question of whether the transferors intention was to have the funds pass to the joint account holder or to have the funds distributed pursuant to the will. When the transferor's intent is unavailable or not clear, the Court turns to the presumption of advancement or resulting trust. The question becomes was this n advancement of an inheritance or was the property transferred to the other party to hold in trust for the beneficiaries of the estate making it a resulting trust. In Madsen the Court clarified that there is not a presumption of advancement where minor children are not involved. In Pecore, the Court went on to indicate that there may be a number of reasons why a joint account may be arranged and in each instance the facts of the case would have to be considered. Making the evidence put forth in a joint account case a key factor in the litigation outcome. In Madsen a resulting trust was found to exist. Bank documents examined in the Madsen case did not provide enough evidence to indicate a true joint account arrangement existed.

   There are also family law issues to consider in the event that the child that holds the property jointly with a parent has marriage dissolution or break down. There is the potential that the property will be included in the equalization calculation in Ontario. Where property is changed from sole ownership to joint ownership tax issues should be considered. For instance, if a family cottage which has appreciated in value is transferred from parent to joint ownership between parent and child, there is a disposition at fair market value of the interest received by the child. The parent must then include any taxable capital gain resulting from the transfer in taxable income. As well, control over the property is lost because the joint tenant's consent is required to sell, transfer or mortgage the property. Joint tenancy also exposes the interest in the property to the joint tenant's creditors.

   A transfer to a spouse may pose a problem. Consideration should be given to provisions under the Family Law Act (Ontario). The surviving spouse may make an equalization claim under the Ontario Family Law Act and since valuation occurs one day before the death of a spouse, the net family property calculation will not reflect the right of survivorship. The result is that the value of the ownership by the deceased spouse will be included in the calculation of the net family property however the asset will have passed under the right of survivorship and is therefore not available to satisfy the equalization claim.

3) An outright gift of property by a parent to a child results in a transfer of assets outside of the estate. Before such action is taken, consideration should be given to similar issues as mentioned above. Again, the parent will lose control over the asset. Also, there may be tax consequences resulting from the transfer of capital property which has appreciated in value. Arguably, the asset may form part of the net family property of the child if there is a marriage breakdown.

4) A transfer of non-appreciated assets to an inter vivos trust will avoid the value of these assets forming part of the estate and being subject to probate. While the transfer of capital property to a trust will result in a disposition of property at fair market value, a more favourable result will arise with the transfer of non-appreciated property. If the trust is revocable, income and capital gains and losses will be attributable to the settlor of the trust during his or her lifetime. As well, revised technical amendments to federal income tax legislation will make it easier for an individual over the age of 64 to use an inter vivos trust as an alternative to a will.

   Like a spousal trust, the alter-ego trust and the joint spousal trust contemplate that the trust will have contingent beneficiaries who will be able to receive income and capital of the trust after the death of the individual or the surviving spouse. The assets in the trust, would not be part of the estate for valuation purposes, and probate is by-passed.

5) Real estate situated outside of Ontario will not be subject to probate in Ontario. However it may be subject to probate in the province in which it is situated. It should be noted that while real estate outside of Ontario is excluded from the calculation, items other than real property such as chattels situated outside of Ontario are included.

6) In Ontario the value of the estate for probate purposes is reduced by an encumbrance against real property. Therefore, debt secured against real property (mortgage) does provide for a reduction of value of the estate resulting in less probate fees.

7) As previously discussed, multiple wills may pose another planning opportunity to avoid the application of probate. One will may deal with assets that require probate while the second will may deal with assets that can be transferred without the need for probate. In Re Granvosky**,** (discussed above) the court accepted this argument. (Note should be taken that planning with multiple wills is not available in Nova Scotia, Manitoba and is uncertain in B.C.).

   As well, one will may deal with assets in Ontario and another with assets in another jurisdiction. While both may be subject to probate, there may be savings if the probate fees are lower in one province.

8) Another planning opportunity that is available is to transfer personal assets and debt to a corporation. The individual would then take back shares in relation to the transfer. This in effect reduces the value of the estate. Since debt can only be used in relation to an encumbrance against real property, the debt could not be otherwise used to reduce the value of the estate. When such a transfer occurs however, the assets are then subject to the creditors of the corporation.

9) A transfer of assets to a province with lower fees or tax may also be a consideration. For instance, if a sole shareholder owns the shares of a company in Ontario it may be desirable to transfer the jurisdiction of the company to another province. However, the difference in provincial tax rates and the capital tax requirements of the other province must be considered.

10) Insurance and annuities (including those registered as RRSPs or RRIFs) paid to a named beneficiary will not flow through the estate or be subject to probate fees. Section 196(1) on the Ontario Insurance Act, R.S.O. 1990, c. I.8., provides that where a beneficiary is designated, proceeds payable under the contract are not part of the estate of the insured. A "beneficiary" is defined as a person other than the insured or his personal representative, to whom or for whose benefit insurance money is made payable in a contract or declaration. This appears to be one of the simplest ways to reduce probate. It may therefore be advantageous to have funds that would otherwise be included in the calculation for probate, for instance investments in GIC's, to instead be used to purchase an insurance product with a named beneficiary. It should be noted however, that where the

estate is made beneficiary under the policy, the whole value of the policy forms part of the estate and is subject to probate.

While Ontario does not require a policy with a designated beneficiary (other than the estate as beneficiary) to be listed on the probate forms the province of Saskatchewan does have this requirement. This reporting obligation does not exist in any other province and means that in Sasketchewan, beneficiary designations are made public when applying for probate.

11) This exception to not include insurance and annuity policies where a designation is made to an individual and not the estate appears to extend to non-insurance RRSPs and RRIFs as well. Although B.C., New Brunswick and P.E.I, are the only provinces which clearly exclude these assets by way of legislation, case law exists which supports the exclusion, (See Baltzan Estate v. MNR [1990] 3 W.W.R. 374, 82 Sask. R. 280, 37 ETR 111 (Sask. Surr Ct.)) but there is conflicting case law on this point. In CIBC v. Beshara (1989) 68 O.R. (2d) 443 (Ont. H.J.C.) the court determined that notwithstanding that an RRSP was purchased from a trust company under which the annuitant designated his spouse as beneficiary, the proceeds passed through the estate. The facts in this case however dealt with creditor issues and not probate. At this point, the case law across the common law provinces provides a mix of decisions.

12) Settlements out of registered pension plans are subject to the various pension benefit acts. Section 48(1) of the Ontario Pension Benefits Act, R.S.O. 1990, c. P.8, for example, provides a deeming provision, which requires payment to the spouse, if one exists at the time of death. Most jurisdictions have similar provisions. P.E.I. is the exception. No pension legislation currently exists in P.E.I. The jurisdictions of B.C., Alberta, Saskatchewan, Manitoba and the Federal Pension Benefits Standards Act (which applies to federally regulated enterprises such as banks) go one step further and prevent a lump sum payment where a spouse is entitled. In these jurisdictions, the benefits must remain locked-in to provide a retirement income for the spouse. Where a spouse does not exist, all jurisdictions allow for the payment of lump sum pension proceeds to a named beneficiary. (See section 48(6) under the Ontario Pension Benefits Act.) Therefore, where there is no spouse or no named beneficiary, the pension proceeds are payable to the estate and thus probate fees are applicable.

13) Where a structured settlement exists, the estate is, in most instances designated as the beneficiary by the owner (the casualty insurer or assignee). The owner prefers a designation to the estate because probate then becomes necessary and the court confirms the validity of the will. The owner can then be certain that the settlement payout is made to the correct beneficiary. In order to avoid payment to the estate, the owner would have to agree to a beneficiary designation other than the estate. A planning technique to avoid probate on the settlement payout is to make the payment to a trustee pursuant to the terms of the will. The trustee is named as beneficiary in the annuity contract and then the funds from the structure would not flow through the estate. It should be noted however, that the owner may be resistant to this arrangement for the reasons outlined above.

14) Employment benefits available through an employer or the government, which are unpaid at the time of death and made payable to the estate of the deceased will be included in the value of the estate. If probate is required to receive the benefit, then the amount of the benefit will be included in the calculation of the value of "all" of the estate.

Appendix A provides an example of assets that would be included and excluded in determining probate fees.

Conclusion

There does not exist a ready-made list to determine what assets will be valued and included for the purposes of determining probate. There are planning opportunities available, which can reduce significantly the amount of tax to be paid. While planning to avoid probate should be considered, such planning should not cloud the testator's true wishes or result in an unfavourable outcome.

The Tax & Estate Planning Group at Manulife Financial write new Tax Topics on an ongoing basis. This team of accountants, lawyers and insurance professionals provide specialized information about legal issues, accounting and life insurance and their link to complex tax and estate planning solutions.

Tax Topics are distributed on the understanding that Manulife Financial is not engaged in rendering legal, accounting or other professional advice. If legal or other expert assistance is required, the service of a competent professional person should be sought.

Last updated: November 2007

APPENDIX A

Determining what assets will be included for the purposes of valuing property for Estate Administrative Tax (EAT) purposes.(Ontario example)

The following facts of a client situation will be used to illustrate assets that will be included and those excluded from the value of the estate for probate purposes:

- Family home in Ontario worth $400,000, and registered solely in the testator's name, with a $150,000 mortgage;
- A quarter-interest in a cottage in Ontario where title is held as tenants in common. There is no mortgage on the cottage and the value of the cottage is $250,000 (the quarter interest is $62,500);
- Life insurance payable to a designated beneficiary worth $500,000;
- A BMW worth $35,000 (with car loan of $15,000);
- A promissory note from a brother in the amount of $50,000;
- A quarter-interest in a ski chalet in Banff, Alberta worth $350,000 held as a tenant in common (the quarter-interest is $87,500);
- RRSPs registered with an insurance company with a designated beneficiary $200,000;
- Canada savings bonds worth $300,000 jointly held with deceased's son and specified as such with the Bank of Canada;
- Shares held in a private corporation (a family-run business) in the amount of $600,000 (these assets are in a second will and the directors do not question the validity of the will).

The estate's value for the purposes of determining the tax in Ontario equals $397,500. It is assumed that for the purposes of this illustration that the shares would not be subject to probate because of the ruling in Re Granvosky (discussed in the Tax Topic) where the court determined that if there is no question as to the validity of the will by the directors of a corporation, and a second will exists to deal with those shares, then the shares will not be subject to probate.

Excluded items:

1) Life insurance - designation is to a named beneficiary and not to the estate;
2) The interest in the Chalet in Banff - the property is outside of Ontario;
3) RRSPs - designation is to a named beneficiary and not to the estate;
4) Canada Savings Bonds - held jointly with a specified designation;
5) Shares - these assets would not be included if the reasoning in Granovsky is followed.

Included items:

1) The family home in Ontario is included but the mortgage can be deducted from the value;
2) The quarter interest in the cottage located in Ontario;
3) The BMW's full value is included. The asset is not real property and therefore the loan cannot be deducted;
4) The promissory note;

The probate taxes payable in Ontario are as follows:*
$5 per $1,000 up to $50,000; and $15 per $1,000 on the balance

In the example above the tax would be calculated as follows:

Total estate for tax purposes = $397,500
Amount payable on first $50,000 of estate = $250
Amount payable on balance of estate = $5,220**
Total tax payable in Ontario = $5,470

**$347,500 remains after the calculation of the first $50,000, this figure is then rounded up to $348,000

***Note: provincial probate fees are subject to change an updated probate chart is located on Repsource.**