IG PRIVATE WEALTH MANAGEMENT

Probate fees: Four advanced financial planning strategies

Most provinces and territories in Canada assess "probate fees" at the time of death. (Except in Manitoba, where there are no probate fees, and in Quebec where most wills are "notarial" and not subject to probate.) However, many individuals are unaware of when probate fees might be assessed, and the advantages and disadvantages of trying to avoid them.

Christine Van Cauwenberghe,
B. Comm (Hons), LL.B.,
TEP, CFP, RRC
Vice President,
Tax & Estate Planning

This white paper outlines when you should or should not consider probate planning. First we'll provide an overview on probate fees and a few of the common strategies for probate avoidance.

Next, we will focus on four advanced probate planning strategies that may be effective in structuring your estate and wealth transfer plan.

01 Alter Ego Trusts and Joint Spousal or Common-law Partner Trusts

02 Insurance Trusts

03 Multiple Wills

04 Transferring Assets to a Holding Corporation

On a relative basis, probate fees are generally much lower than the income tax liability at death

How much are probate fees?

Probate fees (known as “estate administration taxes” in Ontario) are assessed in most provinces and territories. There are no probate fees in Manitoba or Quebec, and the fee charged for probating an estate is very low in some other jurisdictions (e.g. maximum $525 in Alberta and $140 in the Yukon). Even in the jurisdictions that assess probate fees as a percentage of the value of the estate, the fees are less than 1% in every province except British Columbia (maximum 1.4%), Nova Scotia (maximum 1.695%) and Ontario (maximum 1.5%).

Although probate fees can add up for larger estates, on a relative basis, probate fees are generally much lower than the income tax liability at death (given that the highest marginal income tax rates are over 50% in many jurisdictions in Canada). Usually the most effective way to reduce the amount of “tax” owing at the time of death is to concentrate on the income tax liability, not the probate cost. Read our “Estate Planning Guide” for more information on how income taxes are calculated at the time of death and what you can do to plan for, and possibly minimize, this potential liability.

Simple strategies for probate avoidance

Before we discuss the more advanced strategies for probate avoidance, it’s important to mention the two more common approaches. These simple strategies are:

- Adding joint owners to your assets, or
- Designating direct beneficiaries to your plans or policies.

However, you should understand the drawbacks of these strategies, especially when “doing it yourself” without receiving good advice. These “simple” strategies are not suitable for everyone and are often not recommended.

Although these two strategies are the most common probate avoidance strategies, we will not be discussing them in this whitepaper, as we will be focusing on more advanced strategies that are sometimes used by individuals with significant assets. If you would like more information on when joint ownership or direct beneficiary designations may or may not be recommended, please ask your IG Consultant for our white papers on “Adding an Adult Child as a Joint Owner” and “Beneficiary Designations – Do’s and Don’ts”.

Advanced strategies for probate avoidance

We would generally only recommend the strategies discussed in this article if one or more of the following is true:

- Your estate will have a significant value. In order to be worthwhile, the costs of implementing the strategy (including potential ongoing administrative costs), must be significantly lower than the potential future probate fee.
- You wish to avoid a challenge to your will. If you intend to distribute your estate in a manner that you anticipate may result in a challenge by a beneficiary of your estate, or by someone who might expect to be a beneficiary of your estate (e.g. you intend to leave unequal amounts to your children, or completely disinherit one of them), then these probate avoidance strategies may be of larger concern even with a more modestly sized estate. Consider that in British Columbia, surviving spouses and children (even financially independent adult children) may be able to ask a court to vary the terms of your will even if they were not financially dependent upon you; in other provinces various classes of beneficiaries may be able to make a dependants' relief claim. If you are concerned about a beneficiary making a claim against your estate, then you may want to consider some of the strategies discussed in this article (although keep in mind that in Ontario, Prince Edward Island, the Northwest Territories and Nunavut many types of assets can be "clawed back" into an estate for the purposes of satisfying a dependants' relief claim).
- You are concerned about keeping your affairs private. Some individuals are interested in doing probate planning given that your will, once probated after your death, will become a public document. Using these advanced probate avoidance strategies does not guarantee that your affairs will remain private, given that
  - the beneficiaries of your estate may become aware of what has happened once they see certain transactions appear on your final tax return, and
  - the legislation across Canada is evolving to provide for more transparency in the case of trusts. It is possible that one day each of the provinces will have public registries that disclose the names of the ultimate beneficiaries of a trust.

If privacy is a concern, then you should speak to your estate lawyer about what further or alternate actions you may need to take to keep things private.

Alter ego trusts are sometimes used by individuals interested in probate planning, since they allow non-registered assets to be distributed outside of probate.

With that as background, here are four advanced probate avoidance strategies that you may want to discuss with your IG Consultant, as well as an experienced estates lawyer.

STRATEGY #1: ALTER EGO TRUSTS AND JOINT SPOUSAL OR COMMON-LAW PARTNER TRUSTS

Alter Ego Trusts

Alter ego trusts are sometimes used by individuals interested in probate planning, since they allow non-registered assets to be distributed outside of probate. This strategy involves transferring some or all your non-registered assets to a trust during your lifetime on a tax-deferred basis (see the conditions below necessary for this to occur). The trustee of the trust (which could be yourself during your lifetime and your children or other family members if you lose capacity while alive or after the time of your death) would control the assets in the trust, so you could continue to control the assets during your lifetime. However, after the time of your death, the assets in the trust will be distributed according to the terms of the trust (as opposed to your will).

Normally the transfer of non-registered assets into a trust would trigger a "deemed disposition" as of the date of transfer, triggering any unrealized capital gain. However, the *Income Tax Act* allows assets to be transferred to an alter ego trust on a tax-deferred basis where the following conditions have been met:

- the person who transferred the assets into the trust (the "transferor", also known as the "settlor") must be entitled to receive all of the income generated by the trust, every year;
- no one other than the transferor may be entitled to use any of the capital of the trust until the time of the transferor's death;
- the transferor must be at least 65 years of age at the time of transfer;
- the transferor must be a resident of Canada; and
- the trust itself must be a resident of Canada, meaning that the trustee, or a majority of the trustees, should be resident in Canada.

With an alter ego trust, a deemed disposition of its assets will occur upon the death of the transferor. Please also continue to read below for some of the disadvantages of this type of trust.

Joint spousal or common-law partner trusts function similarly to alter ego trusts, but with the inclusion of a spouse.

Joint Spousal or Common-law Partner Trusts

Joint spousal or common-law partner trusts (referred to in this article simply as "joint partner trusts") function similarly to alter ego trusts, but with the inclusion of a spouse. In situations where the estate is of relatively significant value, and there is a desire to avoid the probate process after the death of each spouse (or common-law partner), joint partner trusts may provide a good solution, albeit not in every situation. In order to have a valid joint partner trust under the *Income Tax Act* (which would allow the assets to rollover into the trust on a tax-deferred basis), the following conditions must be met:

- the transferor and/or his or her spouse or common-law partner must be entitled to receive all of the income generated by the trust, every year;
- no one other than the transferor, or his or her spouse or common-law partner, may be entitled to use any of the capital of the trust until the time of death of the last to die of the transferor and his or her spouse or common-law partner;
- the transferor must be at least 65 years of age at the time of transfer (the transferor's spouse does not have to meet this requirement);
- the transferor must be a resident of Canada; and
- the trust itself must be a resident of Canada, meaning that the trustee, or a majority of the trustees, should be resident in Canada.

With a joint partner trust, a deemed disposition of the assets will occur upon the death of the last of the transferor and his or her spouse or common-law partner.

Potential Disadvantages to Using an Alter Ego or Joint Partner Trust

Although these types of trusts may assist in reducing probate fees, they will not in any way reduce income taxes. In fact, there are some potential income tax drawbacks that you should discuss with your advisors prior to implementing this type of plan:

- At the time of your death (or the last to die of you and your spouse in the case of a joint partner trust), there will be a deemed disposition of all of your personally-owned capital assets as well as all of the assets within the alter ego trust or joint partner trust, so the income tax liability will remain the same. (For a discussion of how Canadians are taxed at the time of death, refer to our "Estate Planning Guide".) However, if you had unused capital losses that had accrued in your name personally, and capital gains that are taxed in the name of the trust, there could be a mismatch between the two, resulting in an inability to use the previous capital losses to offset the capital gains experienced by the trust.
- Similarly, if you hold shares of a private corporation, a typical remedy to the double tax on death issue is not available. Normally if shares of a private corporation are redeemed within the first anniversary of death, the capital loss that results from the disposition of the shares can be carried back to the final return of the deceased utilizing the provisions of subsection 164(6) of the *Income Tax Act*. However, this subsection is only available to a "graduated rate estate". As such, ensuring that an element of double taxation does not remain typically requires complex planning which may or may not be available or suitable in all scenarios. Therefore, caution should be exercised before placing private corporation shares within an alter ego or joint partner trust.
- If you would like to make a charitable donation at the time of death, consider leaving sufficient funds in your estate to make the charitable gift from your estate, not from the trust. Charitable gifts made by the trust may be considered a distribution of capital as opposed to a gift, thereby preventing the trust from using the charitable donation tax credit to offset the income tax liability. If your estate qualifies as a "graduated rate estate" under the *Income Tax Act*, certain other tax advantages may be available where the gift is made through your estate as opposed to through a trust. If you intend to make a significant charitable gift at the time of death, speak to a tax advisor when structuring your affairs to ensure that your estate receives the maximum tax benefit from the gift.

> *Even if you choose to transfer the majority of your assets to an alter ego or joint partner trust, it is still important that you have a properly drafted will.*

- If the property transferred into the trust is situated in the U.S., or if you are a Canadian resident but a U.S. citizen or U.S. green card holder, the potential U.S. estate tax implications will need to be considered. The use of such a trust is similar to the use of living trusts in the US, but because you will need to consider the tax regimes of two countries, double taxation may arise without careful planning. In addition, in the case of joint partner trusts, US gift taxes may arise. Using an alter ego trust or a joint partner trust will not avoid or reduce US estate tax, although it may avoid or reduce US probate fees.
- Registered plans should not be transferred into an alter ego trust or a joint partner trust. Transferring registered plans (such as RRSPs, RRIFs or TFSAs) to a trust is generally not a good idea, as the assets in the registered plan will be de-registered and the tax deferral opportunities afforded by those types of plans will be lost. The chief objective of these trusts is to allow the property within the trusts to fall outside of the client's estate and therefore not be subject to the probate process and probate fees. If you own RRSPs, RRIFs, or TFSAs, a beneficiary designation may be more appropriate to avoid probate (although this option is limited in Quebec, and not always suitable in the rest of Canada - see our article "Beneficiary Designations – Do's and Don'ts"). It may be possible to have your registered assets distributed pursuant to the terms of the trust if you designate the trustee of the trust as the beneficiary of those assets, but make it clear that the trustee is receiving the assets in their capacity as trustee of a trust, and is not to keep the assets for themselves.

Even if you choose to transfer the majority of your assets to an alter ego or joint partner trust, it is still important that you have a properly drafted will. While the terms of the trust will outline the ultimate distribution of the trust property upon your death, you may have property that is not owned by the trust and continues to be owned personally (e.g. bank accounts, RRSPs without a beneficiary designation, RESPs, personal effects, etc.). In this case, a will is essential to direct the distribution of these personally held assets. Your will is also where you appoint your personal representative (sometimes known as your executor, administrator, or liquidator) who will deal with your estate, including filing your final tax returns, and where you can make recommendations regarding guardians for your minor children.

Regardless of how the trust is created, it is extremely important that the document in which the declaration is made is dated later than the designation filed with the insurance company so that the beneficiary designation on the insurance policy does not revoke the terms of the insurance trust.

STRATEGY #2: INSURANCE TRUSTS

Designating a direct beneficiary on a life insurance policy will result in the proceeds of that policy going directly to the designated beneficiary, and therefore, probate fees will not be assessed against those funds. However, this strategy can lead to many problems and inequities, and in many cases is not recommended. For example, if you have several children whom you would like to designate as beneficiaries on a plan, but one of them predeceases you, the life insurance proceeds will be paid to the surviving beneficiaries (i.e. your surviving children) and none of the proceeds will go to the heirs of the deceased beneficiary (i.e. your deceased child's children). In other cases, you may wish to put conditions on the receipt of the gift, for example, you may want to indicate that one-quarter of the capital is to be paid at age 25, one-half of the remainder at age 30 and all of the remainder at age 35. These sorts of conditions cannot be placed on a direct beneficiary designation. Further discussion of the problems that can arise when beneficiaries are designated directly on an insurance policy can be found in our article "Beneficiary Designations – Do's and Don'ts".

One strategy that can provide probate savings while avoiding the types of problems mentioned above is the use of an insurance trust. The insurance legislation in most jurisdictions allows funds to be distributed according to the deceased's will while still avoiding probate, if there is an insurance trust that refers to the proper provision in the relevant insurance statute. It is possible to distribute the assets according to an insurance trust either in the will or in a document separate from the will, although it is usually recommended that the insurance trust be drafted separately from the will. Regardless of how the trust is created, it is extremely important that the document in which the declaration is made is dated later than the designation filed with the insurance company so that the beneficiary designation on the insurance policy does not revoke the terms of the insurance trust.

The life insurance trust declaration is applicable only to revoke beneficiary designations dated earlier than the trust. In other words, the life insurance trust declaration will not be applicable to life insurance you acquire subsequent to the date of the insurance trust (whether created in a will or separate declaration). In the case of a discrepancy between a beneficiary designation in the insurance trust and in the life insurance policy, the most recently executed designation will prevail. Therefore, it is important when reviewing life insurance policies that beneficiary designations are not changed without confirming that the new designation will be consistent with the structure of the insurance trust.

> *Multiple wills may not always be a good idea, particularly if the testator anticipates family squabbles arising from the distribution in the will.*

It is also important to note that life insurance proceeds may still be subject to access by the court as part of a dependants' relief claim in the Northwest Territories, Nunavut, Ontario and Prince Edward Island.

For a life insurance trust to be effective, it must be drafted properly. Therefore, it is imperative that you speak to a lawyer who is well experienced in estate planning if you are interested in implementing this type of strategy.

STRATEGY #3: MULTIPLE WILLS

The concept of using "multiple wills" involves distributing any assets that must be probated in one will and distributing assets that do not need to go through probate in another will. For example, real estate and investment accounts are assets that often cannot be distributed to your heirs without letters probate (except in some cases where there is a joint owner), so these assets should be dealt with in one will. However, shares of privately held corporations often do not need to go through probate, since the directors of the corporation are usually close family members or colleagues, who are willing to transfer the shares to the heirs without requiring formal letters probate. Where this is the case, consider multiple wills for the purpose of probate planning. Be sure to speak to your lawyer about this strategy, as it is not effective in every jurisdiction. Of the three jurisdictions where probate fees are above 1%, the courts have allowed the use of multiple wills in British Columbia and Ontario, but the legislation does not allow for them in Nova Scotia. Of note, these wills must be drafted in a very specific manner to be effective, so be sure to see a lawyer who is an estate planning specialist if you are interested in this particular strategy.

Additional care should be taken if the corporation has a sole director, sole officer, and sole shareholder, as in such cases, there is technically no one who can sign a resolution of shareholders to transfer the shares of the deceased. Banks or brokers dealing with the corporation may ask for evidence that the deceased's personal representative is entitled to act, and may thus ask for probate, defeating the whole purpose of creating multiple wills. Where possible, it may be preferable to ensure that the testator is not the sole director and signing officer of the corporation, so that even upon his or her death, the remaining signing officer can proceed alone.

Even where the client has substantial assets which do not "need" to be probated, multiple wills may not always be a good idea, particularly if the testator anticipates family squabbles arising from the distribution in the will. For example, most dependants' relief

> You should also exercise caution if you are transferring assets to an active corporation.

legislation sets out time limits within which claims can be made, that relate to the date in which an application for probate is made. If probate is never obtained, then a dependant could theoretically make a claim at any time against the assets of the non-probated will, even if those assets have been distributed. This latter issue is very important and reinforces the point that probate minimization should not be pursued in estate planning without stepping back and looking at the big picture to determine whether more harm than good is being accomplished by the particular probate fee avoidance strategy.

If you would like to minimize probate fees and are willing to execute multiple wills in order to do so, you should seek professional advice from your lawyer to determine if such a structure would be effective in your province or territory.

STRATEGY #4: TRANSFERRING ASSETS TO A HOLDING CORPORATION

Probate fees are generally assessed against the gross value of an estate, less the value of any debts secured by real property. Unfortunately, personal debt related to the purchase of a business usually will not reduce the value of that business for probate purposes. However, if investments or business assets are transferred into a holding company, and the corresponding debt is also transferred to the holding company, then the value of the asset for probate purposes will effectively be reduced, since the net value of the shares of the holding company will be the value of the assets less the amount of debt. Speak to your advisors before transferring any assets to a corporation, as the transfer must be done in a very specific manner in order to avoid the triggering of capital gains.

You should also exercise caution if you are transferring assets to an active corporation. Shares of a qualifying small business corporation may qualify for the lifetime capital gains exemption, but only if the assets of the corporation meet the various tests in the *Income Tax Act*, including the need to limit the amount of passive assets in the corporation. If you have an active business corporation, it may be better to transfer passive assets into a separate corporation to preserve the availability to claim the lifetime capital gains exemption on the shares of the active corporation. Consider also that the costs of incorporating and maintaining a corporation can become relatively high, so this strategy will be more effective where the probate savings are significant. Finally, keep in mind that this strategy may be used in combination with the multiple will strategy, referred to earlier, in certain jurisdictions.

As can be seen, these strategies can become quite complex, and it is extremely important that you obtain professional advice before implementing any of them. Please speak to your IG Consultant for more information on how to best structure your estate and wealth transfer plan.

ABOUT THE AUTHOR

Christine Van Cauwenberghe
B. Comm (Hons), LL.B., TEP, CFP, RRC
Vice President, Tax & Estate Planning

Christine is Vice President, Tax & Estate Planning at IG Wealth Management, where she provides advice to high net worth clients on complex tax and estate planning issues. Christine is a member of the Canadian Tax Foundation, has her CERTIFIED FINANCIAL PLANNER™ designation and is a Registered Retirement Consultant and Trust & Estate Practitioner, certified by the Society of Trust & Estate Practitioners (STEP). She is also the recipient of the prestigious STEP Founder's Award. Christine is the author of *Wealth Planning Strategies* for Canadians, which is published annually by Thomson Carswell and is currently in its 16th edition. Christine has given lectures to numerous professional associations and is a regular media spokesperson for IG Wealth Management.

igprivatewealth.com

This is a general source of information only. It is not intended to provide personalized tax, legal or investment advice, and is not intended as a solicitation to purchase securities. For more information on this topic or any other financial matter, please contact an IG Consultant. Trademarks, including IG Wealth Management and IG Private Wealth Management, are owned by IGM Financial Inc. and licensed to subsidiary corporations. Insurance products and services distributed through I.G. Insurance Services Inc. Insurance license sponsored by The Canada Life Assurance Company.

© Investors Group Inc. 2021 EST2174HNW_E (07/2021)