



ESTATE ADMINISTRATION TAX – THE NIGHTMARE BEGINS

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It has been 19 years since Ontario's probate fees -- the forerunner of estate administration tax (EAT) – were effectively tripled. Since that time, a generation of Ontarians has had ample opportunity to implement a variety of planning techniques intended to minimize EAT exposure on death -- with a significant adverse impact on EAT revenues.¹ However, the proposals contained in Ontario's 2011 Budget suggest that the provincial government believes the disappointing EAT revenues are attributable to the propensity of applicants for a certificate of appointment of estate trustee (a "certificate") to engage in EAT evasion – by lying under oath when declaring the value of the estate. How else to explain the lengths to which the government has declared its intention to go to boost the EAT revenue figures?

Bill 173 was introduced in the Ontario Legislature on the same day as the 2011 Budget was presented. Schedule 14 to the Bill proposed dramatic changes to the *Estate Administration Tax Act, 1998*.² Those changes will require an applicant for a certificate to "give the Minister of Revenue such information about the deceased person as may be prescribed by the Minister of Finance ... within the time and in the manner as may be prescribed by the Minister of Finance".³ It is reasonable to assume that the regulation

¹ In the writer's view, there is clear evidence of that impact. Ontario's EAT revenues for the fiscal period ended March 31, 2010 totaled approximately \$107 million. Had there been no rate hike in 1992 and had the historical rate of probate fee revenue growth during the 20-year period immediately prior to that hike continued up to the end of the 2010 fiscal year, EAT revenues would have been in excess of \$158 million. It follows that if there had been no public reaction to the rate hike, the EAT revenues at the end of fiscal 2010 would have been in excess of \$474 million.

² The government employed a "hurry-up" offence to get the Bill passed. After three days of debate during Second Reading in the Legislature, "time allocation" was ordered on April 13th. The motion for Second Reading was carried the following day and the Bill was referred to the Standing Committee on Finance and Economic Affairs (the "Standing Committee") with strict marching orders: (i) hold one day of public hearings on April 21st; (ii) propose any amendments to the Bill by April 28th; (iii) conduct clause-by-clause study on May 5th; and (iv) report back to the Legislature by May 9th. The Standing Committee kept to this time line and reported back to the Legislature on May 5th. There were no amendments to Schedule 14. On May 10th, the motion for Third Reading of the Bill was carried. On May 12th, it received Royal Assent.

³ The *Estate Administration Tax Act, 1998* already empowered the Lieutenant Governor in Council to make regulations "prescribing procedures to be followed and information or evidence to be given to any person by a person applying for an estate certificate, for the purpose of establishing the value of the estate." The amendments will give the Minister of Finance express authority to make regulations to prescribe the information to be given, as well as the timing and manner for doing so. While this may

will require an applicant for a certificate to provide the Minister of Revenue with an inventory of estate assets and a declaration as to the value of each of them. In and of itself, this does not impose any significantly increased burden on the applicant. And we may expect the government to point out that this requirement is one already imposed in a number of other provinces.⁴ This new filing obligation will not apply to applications for a certificate made before January 1, 2013.⁵

What should be of greater concern, however, are the audit and verification powers that the government has given the Minister of Revenue. They are patterned after the assessment, objection and appeal mechanisms in the federal *Income Tax Act*. The Minister of Revenue now has the right to assess an estate in respect of its EAT liability. Assuming the filing of the application with the appropriate estates office is distinct from the filing of the inventory and valuation with the Minister of Revenue, the possibility of an assessment should not hold up the issuance of the certificate. However, some time after the certificate has been issued, the Minister of Revenue may choose to conduct a closer examination of the inventory and valuation provided in that separate filing and, where a greater estate value is thereby determined, assess the additional EAT to be paid.

The time frame within which that assessment -- or reassessment after an initial assessment -- can be carried out is four years from the date that EAT became payable (that is, the date of filing of the initial application).⁶ However, an assessment or reassessment may be made at any time that the Minister considers reasonable, upon establishing: (i) that the estate trustee has not filed the information required; or (ii) that any person has:

made a misrepresentation that is attributable to neglect, carelessness or wilful default, or has committed any fraud in supplying any information regarding an estate or in omitting to disclose any information regarding the estate.

The necessary tools to permit the Minister of Revenue to conduct that closer examination have also been added to the *Estate Administration Tax Act, 1998* – through incorporation by reference of the powers the Minister now possesses under the *Retails Sales Tax Act*.

expedite the making of those regulations, they must still be filed with the Registrar of Regulations and be published, either in the Ontario Gazette or on the Ontario government's e-laws website, before they can take effect.

⁴ For example, British Columbia, Nova Scotia, Prince Edward Island and Saskatchewan. However, in none of those jurisdictions does it appear that the revenue ministry is tasked with the responsibility for audit and verification (as is the case under Bill 173, per the discussion in the paragraph of the text immediately following).

⁵ The Minister or Revenue may prescribe a later effective date.

⁶ Where property is later discovered by the estate trustee that requires a further affidavit to be given and additional EAT to be paid, it is likely that the estate trustee will be required to file additional information with the Minister of Revenue. It is unclear from the amendments whether, in such a case, the statutory period for (re)assessment commences anew for the entire EAT liability or only in respect of the EAT payable as a consequence of the later-discovered property.

They include the power to require the estate trustee to provide all reasonable assistance with, and answer all questions pertaining to, the audit or examination being conducted, as well as the power to require third parties (i) to give the Minister access to their premises; (ii) to permit examination of assets and records; and (iii) to respond to the Minister's demands for information.

As with other taxing statutes, penalties have been added to the *Estate Administration Tax Act, 1998* to encourage compliance. Once the regulations are in place, it will be an offence for an estate trustee to fail to make the required filing with the Minister of Revenue. It will also be an offence for any person who makes, or assists in making, a false or misleading statement (or a statement that omits a fact that results in the statement's being false or misleading) in connection with the estate trustee's filing. Anyone charged with the latter offence will have a defence if he or she "did not know that the statement or omission was false or misleading and in the exercise of reasonable diligence could not have known that the statement or omission was false or misleading." Offences are punishable by fine, by imprisonment or by both. The minimum fine will be \$1,000. The maximum fine will be twice the EAT payable.⁷

Although the requirement to file with the Minister of Revenue will not take effect until the regulations are in place, the Minister's authority to (re)assess an estate for EAT became effective when the Bill received Royal Assent on May 12, 2011 – even, evidently, in a case where the application for a certificate was filed before Royal Assent (subject to the statutory limitation periods on assessment referred to earlier). However, the penalty provisions relate specifically to the prescribed information to be provided to the Minister of Revenue in new section 4.1. Accordingly, they cannot be applied to cases of false or misleading statements for an estate where the application was made before January 1, 2013.⁸

The biggest uncertainty with these amendments pertains to their possible impact on the winding up of an immediately distributable estate. That impact will depend on a fundamental question; namely, whether an estate trustee is exposed to personal liability if the estate has been distributed before the Minister of Revenue issues a notice of (re)assessment for additional EAT. Missing entirely from the new scheme for audit and verification of EAT is the concept of a clearance certificate which would protect the estate trustee if it is obtained before final distribution of the estate.⁹ However, the

⁷ With regard to false or misleading statements, the wording of the amendment suggests that the maximum fine will be calculated with reference to the total EAT liability of the estate, as opposed to being calculated with reference to the amount of the EAT underpayment attributable to the false or misleading statement. This is unlikely to be the interpretation applied, as it could result in a disproportionate fine for a modest underpayment of EAT in a very large estate.

⁸ However, see note 19, *infra*.

⁹ During the public hearing before the Standing Committee, the writer proposed the addition of an EAT clearance certificate. The opposition members on the Standing Committee proposed such an amendment but it was voted down during clause-by-clause study.

government evidently considers this to be a non-issue because of subsection 2(8) of the *Estate Administration Tax Act, 1998*, which provides that “[t]ax is payable by the estate representative in his, her or its representative capacity only.”¹⁰

This provision was included in the statute when it was originally enacted in response to the Supreme Court of Canada decision in *Re Eurig Estate* that struck down probate fees as being unconstitutional. Its inclusion precludes any possibility that the new estate administration tax might be vulnerable to a challenge on the grounds that it is an indirect tax – a tax that no province has the constitutional authority to impose.¹¹

The writer questions whether that provision will offer sufficient protection to the estate trustee. Consider the example of an estate trustee who makes a distribution of the estate very soon after the testator’s death – perhaps even before he or she is required to file with the Minister or Revenue. Trust law imposes on the estate trustee an obligation to take reasonable steps to see that all of the testator’s creditors have been paid -- or that their claims are adequately secured -- before making a distribution of the estate to the beneficiaries. The estate trustee who fails to do so may be personally liable for the claims of creditors that cannot be paid as a result of the estate distribution. If the Minister of Revenue alleges that the speedy estate distribution was the result of a cavalier attitude on the part of the estate trustee towards the possibility of an assessment for additional EAT, would the estate trustee be able to hide behind subsection 2(8) of the statute? Is it not possible that the estate trustee will be found liable under trust law principles for having failed to protect a creditor’s claim that the estate trustee knew, or ought to have known, was likely to arise?¹²

Bear in mind also that subsection 2(8) of the *Estate Administration Tax Act, 1998* will not protect the estate trustee from the imposition of a fine if he or she is determined to have been responsible for a false or misleading statement (assuming the defence of “reasonable diligence” cannot be made out). If the estate has been distributed, the estate trustee will have to fund his or her defence, as well as the fine.¹³

¹⁰ Interestingly, it is the “estate” that is subject to (re)assessment. The estate is hardly a legal entity. This may be contrasted with the *Income Tax Act*, subs. 104(1) of which deems any reference to an “estate” or “trust” to be a reference to the person who has control over it. In this way, effective compliance is ensured by imposing upon the personal representative or trustee income tax filing and payment obligations.

¹¹ See *Re Eurig Estate*, [1998] 2 S.C.R. 565, at para. 26.

¹² Perhaps the government has anticipated that this risk would, as a practical matter, create the necessary brake on “early” estate distributions. As well, the possibility of an EAT (re)assessment could open the door to recovery of the estate assets from the beneficiaries -- if the requisite intention can be demonstrated -- on the grounds that the distribution was a fraudulent conveyance.

¹³ Even if the estate trustee has the practical means to pursue reimbursement from the estate beneficiaries for these personally incurred liabilities, he or she may, depending on the circumstances, find it difficult to establish the right to be made whole.

But if the estate trustee is not liable for the additional EAT owing on a reassessment, how does the Minister of Revenue intend to collect where an estate has already been fully distributed? While the creditor of the deceased is entitled to pursue estate assets into the hands of a beneficiary, what collection methods will be available to the Minister of Revenue where the beneficiaries are across the country or around the globe?

New subsection 4.6(1) of the *Estate Administration Tax Act, 1998* provides, “An estate representative may object to or appeal from an assessment or a reassessment made in respect of an estate under this Act.”¹⁴ If the estate has already been distributed, presumably the beneficiaries who wish to fight the (re)assessment will be obliged to provide the funds to the estate trustee in order to fund the objection or appeal. What if the estate distribution has been made to beneficiaries A and B, where A is in Ontario and B is in Asia? Suppose A, who has the practical risk of having to pay the additional EAT, wants to fight the assessment but B does not. Evidently, A will have to fund the entire cost of the dispute.¹⁵

It remains to be seen how the EAT auditors will approach their task. We may reasonably expect that where the value of a particular asset cannot be objectively ascertained (for example, the value of shares of a private corporation or the value of real property that is not being sold), the Ministry of Revenue will be prepared to bring in its own valuator.¹⁶ However, a government zealous for additional revenues could choose other battlefields. Will there be fights over the question as to whether a debt owing to the estate is statute-barred from collection (and hence valued at nil)? Will there be challenges to the validity of a beneficiary designation that would take insurance money, RRSPs, RRIFs or TFSAs out of the estate for EAT purposes?¹⁷ Will there be disputes as to the intention of a deceased parent when he or she made a bank or investment account joint with an adult child?

¹⁴ The procedures to file a notice of objection and, if the Minister confirms the (re)assessment, to further appeal to the Superior Court of Justice, are set out in the provisions of sections 24 to 30 of the *Retail Sales Tax Act* that have been incorporated by reference into the *Estate Administration Tax Act, 1998*.

¹⁵ Similar unfairness can arise in the case where a part of the estate has been paid out to an adult child and the rest of the estate is being held in trust for one or more minor children. The estate trustee will be able to take back from the share(s) held in trust a proportion of the cost of challenging the assessment, but may be unable, as a practical matter, to get the adult child to ante up.

¹⁶ In the case of income tax disputes, it is well-settled law that the taxpayer bears the onus of disproving the facts underlying the Minister of National Revenue’s (re)assessment. The amendments to the *Estate Administration Tax Act, 1998* do not address this issue, although it is likely that a similar principle will eventually be established by the jurisprudence pertaining to that statute.

¹⁷ In *Baltzan Estate v. Royal Bank*, [1990] 2 C.T.C. 232, [1990] 3 W.W.R. 374, 37 E.T.R. 111, 82 Sask. R. 280, the Minister of National Revenue sought to invalidate an RRSP beneficiary designation so as to make the RRSP funds available to satisfy a Requirement to Pay.

Do the amendments to the *Estate Administration Tax Act, 1998* pose any risks to the lawyer who acts for the estate trustee? As indicated above, it is assumed that the filing with the Minister of Revenue is entirely distinct from the filing of the application for a certificate. The penalties described earlier pertain only to the information to be filed with the Minister of Revenue. If the lawyer does not participate in the preparation of the documents for that filing, he or she should have no reason for concern. That said, the value of the estate as reflected in the application for the certificate must be consistent with the value of the estate reflected in the filing with the Minister of Revenue. It will therefore be incumbent upon the lawyer to advise the client of the importance of declaring a value that can be substantiated if it comes under the scrutiny of the Minister of Revenue, and to ensure the client understands the risks of an adverse assessment (not to mention the potential of fines for a false or misleading statement).¹⁸ It would be incumbent upon the lawyer as well to point out that the four-year limitation period on (re)assessments will not apply where there has been a misrepresentation attributable to neglect, carelessness, wilful default or fraud.¹⁹

Will there be “enhanced compliance” -- to use the government’s words -- with the obligation to pay EAT as a result of these new powers given to the Minister of Revenue? More important, will there be sufficient new EAT revenues arising from the new audit and verification procedures so as to offset the cost of the additional government resources that will be needed for the task?²⁰ The writer is doubtful. Perhaps the new audit and verification powers given to the Minister of Revenue are merely a scare tactic, intended to discourage persons from bringing either a lax attitude or a dishonest motivation to the estate valuation exercise. We shall see.

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¹⁸ Of course, a lawyer who oversees the application for a certificate of appointment of estate trustee has always had to be satisfied that the applicant is not swearing a false affidavit with regard to the values for real and personal property that are set out in the application.

¹⁹ In the event of such misrepresentations, new paragraph 4.5(2)(b) gives the Minister an unlimited period of time within which to (re)assess. On a strict reading of that provision, those misrepresentations are not limited to the filing with the Minister of Revenue. It appears that a misrepresentation on the application for a certificate of appointment of estate trustee could itself open the door to an assessment indefinitely into the future – even, as the text indicates, where the application pre-dates Royal Assent.

²⁰ Perhaps this issue will be addressed in a future report from the Office of the Auditor General.