

Estate Planning Issues for Consideration

One of the most important and often neglected aspect of our lives is planning for our eventual passing. All of us have heard the common phrase that the only thing for sure in this life are death and taxes and yet a large majority of people fail to plan for this occurrence. Designing a proper estate plan can be anything from a very simple exercise, if the individual has few assets to a very complicated and technical exercise where the estate assets are more numerous and varied. It would be impossible to discuss all issues associated with every aspect of an estate plan in this small article, and as such my intent is not to conduct an in-depth analysis of all issues that should be considered when discussing with a client their estate planning needs but to provide a general overview for discussion purposes of the most common issues encountered when determining how to plan their estates.

The three areas associated with any estate plan that arise most often involve the transfer of private closely held corporate shares; the transfer into joint tenancy of real property or other assets; and the preparation and implementation of powers of attorney and a last will and testament.

Corporate Estate Freeze

I will firstly discuss some of the potential issues associated with the transfer of shares owned by an individual in a Canadian Controlled Private Corporation. In this respect a brief overview of corporations may be of assistance. What is a corporation, and why would someone wish to incorporate a business, or simply form a corporation for any purpose?

A corporation is considered to be a separate legal entity and is treated like an individual, with one major difference being that it has perpetual existence, which is a key characteristic in attempting to avoid the deemed disposition of ones assets on death. When an individual passes away it is deemed for tax purposes that they have sold all of their assets at fair market value unless very specific and limited conditions are met with respect to the transfer of those assets. Whereas a corporation will continue on forever and the death of the individual will not trigger the deemed disposition of the underlying corporately held assets.

Most corporations are created for two main reasons: a) tax planning issues and the re-distribution of income as corporate tax rates are normally lower than individual tax rates;

and, b) limitations of liability to the shareholder (owner). In order to enjoy the benefit of these two aspects of incorporation the individual must ensure that the corporation is maintained and that it files annual corporate tax returns or they may lose some of the benefits for which it was incorporated.

As stated, upon passing of the individual there is no deemed disposition of the assets held by a corporation as it goes on for perpetuity. However there is a deemed disposition of the shares held by the individual and most estate tax planning associated with corporations revolves around these shares and what is done to avoid any capital gain that may arise from such deemed disposition, or to avoid probate fees (taxes) on the value of these shares.

A proper estate plan will ensure that there are no issues with respect to probate fees as most private corporate shareholders should have dual or multiple wills to deal specifically with these shares. That concept will be discussed later in this article.

However the avoidance or reduction of capital gain taxes gives rise to the need to transfer those shares to another party, usually the next generation. In addition most people would prefer to do this without losing control of the corporation derived from the ownership of those shares. The most common method used to accomplish this goal is what is called an 'estate freeze' of the value of those corporate shares. An estate freeze can also be accomplished for any assets, such as investment portfolios, real property or personal property.

Through such an estate freeze the transferring party would create a new corporation (most commonly referred to as a "holding company") whose common shares can be held by the children (or any other party) and he would then sell his other corporate shares, investment account, or any other assets to the holding company in exchange for fixed value preference shares of the holding company, along with any other consideration desired (such as a promissory note) which total would equal the value of the shares or assets sold to the holding company. This way the value of the individual's share in the holding company is frozen at a set amount, being the amount for which the assets were sold to the holding company, and the receiving party (usually the children of the individual) will enjoy the growth in the asset through the growth in value of their common shares in the holding company. The individual's interest in the holding company can then slowly be reduced through the structured redemption of the preference shares or repayment of any debt created upon the freeze.

There are many issues to be considered in any estate freeze situation including but not limited to:

- control of the new holding company (the parents can continue to hold voting control through votes connected to the preference shares received if the share provisions have been properly structured);
- share structure and election of officers and directors of the new holding company;
- the ability of the individual to request the redemption of the holding company's preference shares or the ability of the holding company to retract those preference shares and the value for such redemption.

There are many complex issues associated with any estate planning involving corporations other than mentioned herein. Any individual who has corporate interests should always seek professional advice with respect to their estate plans to ensure the desired results are achieved.

Joint Tenancy

Another very common estate planning tool involves the concept of joint tenancy, also sometimes referred to as joint tenancy with the right of survivorship. This is a legal concept and means that upon the death of one of the joint tenants the surviving joint tenant is entitled under law to be the sole and rightful owner of the assets automatically without having to do anything further. Most commonly this concept is used for the holding of real property by two parties but can be used for the holding of assets of any nature. It is a very widely used concept in an attempt to avoid capital gain taxes or probate fees by transferring property to joint tenants before death. As with corporate issues each estate plan involving transferring assets into joint tenancy is dependant upon the specific facts, however, there are some general principals that should be considered.

The transfer of assets into joint tenancy is the most commonly used estate planning technique between parents and children when one of the parents has passed away leaving a surviving spouse who is elderly and unable to deal with their assets without the assistance of a third party, normally being one of the children. The surviving parent will transfer any homes, investments, bank accounts or other assets to both themselves and the child as joint tenants.

However when the joint tenant is not the spouse there are other issues that must be considered such as:

- any tax implications upon the transfer of the property
- loss of control over the asset which may be problematic if the parent wishes to deal with the asset at a later date
- consideration of siblings who are not added as joint tenants, and how they are to be treated.
- there must be a certain amount of trust and an excellent relationship between the joint tenants
- exposure of assets to the creditors of the joint tenants

These points for consideration raise the possible negative consequences of joint tenancy. The property becomes subject to the creditors of either joint tenant and if the child is heavily indebted the parent may not wish to jeopardize the asset by exposing it to these debts. In addition, any future dealings with the property would require the consent of both joint tenants which may be difficult if the parties have had a falling out and are no longer communicating effectively. One other very important consideration is the intention of the parent at the time the property was transferred into joint tenancy. Was the transfer intended to be a gift to the child or was it simply done to allow the child more flexibility and ease in administering the estate of the parent?

Two recent cases in the Supreme Court of Canada, namely: *Pecore v. Pecore* and *Madsen Estate v. Saylor*, have shed some new light on transferring assets to joint owners. The issue reviewed in these cases is whether the transfer into joint tenancy with a child was intended to transfer the asset outright or was intended to transfer the asset only for the sole purpose of assisting the transferor to administer his affairs.

The Supreme Court clarified that there are two presumptions associated with the transfer of assets into a joint tenancy. Firstly the presumption of a resulting trust which indicates that if one party transfers property to another gratuitously then the law will assume that the transfer was intended as a trust and not as a gift. The person holding title to the asset does so for the benefit of the transferor as trustee, and not for themselves. There is a transfer of legal title only and not beneficial title. The second presumption is the presumption of advancement which presumes that the gift is intended to be an outright gift and as such both legal and beneficial title is presumed to have been transferred. This principal can be used to defeat the principal of a resulting trust in certain circumstances. Usually this presumption takes precedence when the receiving party is a minor.

The problem is that in Ontario both presumptions still exist and can create

difficulties. For example, if a parent transfers a property to one of the children as joint tenants and then passes away, it must be determined if it was the parent's intention to have the child receive the property outright on the death of the parent, or if it was the parent's intention to have the property or the value thereof divided among all of the children in accordance with any wishes in the parent's Will.

The real meaning of these two cases, Pecore and Madsen Estate is that all of the facts need to be considered to determine what the true intention of the transferring parent was. As a general rule it is presumed that a transfer to an adult is governed by the presumption of a resulting trust and that a transfer to a minor is governed by the presumption of advancement unless there is evidence to the contrary.

Therefore it is strongly advised that any person considering such transfers sign a written statement of their intention at the time that the transfer is made. Such written statement may also assist in the event the receiving child creates a problem in the future by refusing to deal with the property or going against the wishes of the parent.

The transfer of the family cottage property into joint tenancy must also be very carefully considered as a large number of problems may arise when dealing with the cottage after the parents pass away. These problems associated with the ownership of cottage property certainly include, but are in no way limited to:

- ownership of the cottage
- responsibility of maintenance and upkeep
- use of the cottage
- disposition of the sale proceeds
- responsibility of the tax consequences upon sale
- and many other issues which may also need to be dealt with even before a determination is made to transfer the cottage into joint tenancy.

As a result cottage properties are often treated separately under the will of the deceased individual and may often include the creation of a cottage trust to deal with the complex issues arising from the ownership of cottage property. The concept of trusts will be very briefly dealt with later in this article.

Will and Powers of Attorney

The final area that I wish to discuss would be the implementation of a valid Will and Powers of Attorney for an individual. There are two types of Powers of Attorney in Ontario,

a Power of Attorney for Property and Power of Attorney for Personal Care.

The Power of Attorney for Property deals with the assets of an individual. This can be a limited Power of Attorney but in most cases, especially for estate planning purposes, it is a 'general' and continuing Power of Attorney so it can be used for all assets when required. The Power of Attorney for Property is effective immediately upon execution and based upon its wording in most cases is continuing in nature. This power of attorney can be used to deal with any and all assets of the individual and will not require proof of incapacity of the individual granting the power of attorney.

Unfortunately as a result of recent frauds perpetrated by people using Powers of Attorney for Property, Teraview, the government real property registration system used in Ontario, has recently been changed in an attempt to reduce the fraudulent use of such Powers of Attorney. As a Power of Attorney for Property is effective immediately and affects all assets of the individual, they were being forged and used by criminals to transfer properties to themselves, or fictitious characters created by them, and then mortgages were arranged and registered against these properties and the individuals were absconding with the mortgage funds before the true owners of the properties were made aware of the fraud. As a result, transfers currently conducted under a Power of Attorney now have much more stringent requirements.

The second type of Power of Attorney is a Power of Attorney for Personal Care. A Power of Attorney for Personal Care is used for medical decisions and will require proof of incapacity for its exercise. This Power of Attorney will, in many instances, also contain the 'living Will' clauses which are more commonly referred to as the 'pull the plug' clauses. These provisions allow the named Attorney to make the decision that no extraordinary means shall be used to prolong the life of the individual.

The last and possibly most important document in any estate plan is a properly thought out and prepared Last Will and Testament. A Will is designed for the distribution of the assets of the deceased and to ensure that his or her estate is administered in accordance with their last wishes.

If a Will is not prepared, upon the passing of the individual, his assets will be distributed in accordance with the intestate succession provisions in Part II of the Succession Law Reform Act of Ontario, and the appointment of a Trustee for the Estate must be determined by an application through the courts. The provisions of a will can be very flexible in order to meet all of the needs or wishes of the deceased, and may include

any number of items such as:

- specific gifts to individuals or charities
- creation of testamentary trusts for the benefit of any number of specific beneficiaries
- dealing with corporate shares
- appointing the guardians of any minor children
- any other wishes and desires of the individual

As previously mentioned it is common to create trusts through a will which trusts are referred to as 'Testamentary Trusts'. In contrast a trust created while the individual is alive is referred to as an 'Inter-Vivos Trust'. A Testamentary Trust is subject to graduated tax rates on its income like an individual; whereas an Inter-Vivos Trust is subject to the top marginal tax rates from its first dollar of income. Most wills create one or more Testamentary Trusts which can be as simple as requiring that a child reach a certain age before being entitled to receive a distribution under the will. A further common trust provision in a will may provide for the distribution of assets to a disabled individual who is receiving government assistance as a result of their disability, and do not wish to have a negative effect upon the receipt of such assistance. Provisions of this nature are commonly referred to as 'Henson Trust' provisions.

Another important aspect of wills is the ability to have dual, or multiple wills, to avoid probate fees with respect to assets that do not have to be probated. The most common example of assets which do not require probate are privately held corporate shares. The creation of multiple wills should always be considered when an individual owns private corporate shares, but care must be taken to ensure that any dual wills are properly drafted as the improper creation of dual wills may invalidate both wills and defeat the purpose for which they were created. It is important that the wording in each will does not inadvertently revoke the other will. The assets that would be subject to probate would be included in what is referred to as the 'Primary Will', and the assets that would not require probate would be included in the 'Secondary Will'.

If an individual holds private corporate shares with an underlying value of \$1 Million, those shares can be distributed to a beneficiary under the terms of the Secondary Will without probate thus saving substantial probate fees.

The concept of probate is widely discussed but to a large extent misunderstood by the general public. Under Ontario law there really is no such thing as probate currently. It is now called an 'Appointment of Estate Trustee With/Without a Will', and the fees are

in reality taxes charged by the Ontario Government as established by Section 2 of the Estate Administration Tax Act, and are currently at a rate of \$5 per \$1,000 on the first \$50,000 of the value of the estate assets, and \$15 per \$1,000 thereafter.

What is probate? Probate is simply the Court approving who the legal representative of the Estate is, and confirming the Last Will and Testament of the deceased. The Trustee of any estate, where there is a will, derives their powers from the will itself. Probate is the method designed to allow third parties the freedom to deal with the appointed Estate Trustee without having to worry about being sued for dealing with a Trustee who may not have the authority granted under a valid will. If a third party makes a payment or transfers an asset outside the authority of the Will, or under the instructions of the wrong Trustee, such party may be required by the rightful trustee and the courts to make that payment to the rightful person and thus be forced to make the same payment twice.

That is why only some assets require probate where others may not. If there is no third party involved, such as in the transfer of private corporate shares between family members, then those particular assets can be transferred without probate as the parties dealing with the shares will usually be intimately involved with the transferor's estate and the corporation, and will not have any concerns with respect to the transfer of those shares.

In addition probate is also avoided on assets that do not pass directly through the estate. One of the best examples of such assets is insurance policies that have a designated beneficiary other than the estate.

There are many steps that can be taken to either avoid payment of probate fees or reduce the extent of such fees when someone is undertaking an estate planning exercise.

This article is intended only as a very brief discussion of the issues associated with any estate planning exercise, and in particular with the three specific areas set out herein, and it is strongly recommended that such exercise involve the individual's lawyer, accountant or financial planner, and insurance agent to ensure a proper plan is prepared and implemented.

That concludes this article, and I encourage you to contact me should you have any questions or wish to discuss any of the issues raised herein.

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