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New Federal Regulations regarding the Taxation of Estates in Canada

Estate Tax Changes

As of December 31, 2015, estates will be allowed a 36 month period (as "graduated rate estates" – GRE), where income generated in the estate will be taxed at marginal rates. For those estate funds that have been fully distributed within three years after the death of the testator (the person who has made the Will), any income generated from the estate monies will be taxable at marginal rates. After the 36 month period, the estate would be taxed at the top tax rate.

Trusts

Despite many representations from legal, accounting and financial planning communities about the benefits of trusts established in Wills, the federal government still passed new estate and trust legislation. The new legislation eliminates most of the advantages that have been enjoyed by those testamentary trusts since 1972.

After 36 months, any trusts that were created by the Will are to be taxed at the top tax rate, which is approximately 46 per cent in Ontario.

In the past, many Spousal Trusts, in which the sole beneficiary, and often the sole Executor, was the spouse, were created because of the potential for income splitting between the spouse and the trust. The income-splitting potential that motivated the creation of many testamentary trusts, where some of the income would be taxed in the trust and some in the hands of the beneficiary, now no longer exists. Anyone who has an estate plan that includes trusts will want to rethink their approach. Consider the following points:

- the additional administration issues accompanying an on-going trust,
- including an additional tax return for each year that the trust operates, and
- the need to maintain a separate set of estate investments,
- is the trust worthwhile when there are no tax benefits?

There is one exception to the tax rate change for income taxed in a trust. That is for a trust that is established for a disabled beneficiary. These trusts are often referred to as Henson Trusts, so named for the original case where the court approved the use of such trusts. This type of discretionary trust prevents any capital or income from the trust from being treated as belonging to the disabled person. This trust allows the disabled beneficiary to remain entitled to whatever provincial disability benefits are available. Extra funds can still be provided by the trust to meet the needs of the disabled beneficiary. Under the new rules that came into place on January 1st, undistributed income in a trust will still be taxed at marginal rates. But, the beneficiary will have to qualify under the income tax rules for a disability tax credit. The trustee will have to file an annual election document to keep the trust qualified to pay tax at the marginal rates.

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As well, and an important point in terms of family estate planning, only one discretionary trust per disabled person will qualify for marginal tax rates. So, if both the parents and grandparents of a disabled child set up Henson Trusts in their Will, only one of those trusts will qualify for marginal tax rates on the accumulating income.

Multiple Wills

Regarding the practice of creating multiple Wills, there has been a significant advantage from the perspective of Estate Administration Tax, formerly known as probate fees. Creating one Will intended for assets that requires probate and a second Will that deals with assets that can be transferred without the need for a Certificate of Appointment of Estate Trustee with a Will (required for probate), means there is no need to pay probate on the value of those assets.

As of January 1, 2015, there has been an obligation on estate Executors/Trustees to file the Detailed Information Return with Ontario Minister of Finance setting out the nature and history of the assets in an estate. The filing must be made by the estate Trustee within 90 days of the issue of the Certificate of Appointment. The Ministry of Finance has the authority to audit and reassess any tax.

Certain assets can be transferred through a "Secondary", "Non-Probate" or "Private" Will without the need for a Certificate of Appointment. This saves the Estate Administration Tax (probate) on the value of the assets. There is no need to report the assets and the values in the Detailed Information Return that must be filed.

"Secondary", "Non-Probate" or "Private" Wills have generally been used to deal with shares in private companies controlled by the testator (the person who has made the Will) or by close family members. This is because shares can be transferred by the company directors. In addition to private company shares, there are a number of other assets that can be included in such a Will. These include art, jewellery, motor vehicles and boats. All of these can be transferred or sold without having to have a Certificate of Appointment of Estate Trustee to secure the transfer.

To reduce Estate Administration Taxes (probate), Canadians have used joint accounts. They simply added the name of another family member or members to a bank account, investment account or real estate title. The new Information Return required in Ontario treats such joint accounts as estate assets and is now subject to Estate Administration Tax (probate). Anyone intending to have a jointly held asset will have to deal with the joint account in a "Secondary", "Non-Probate" or "Private" Will to keep the asset out of the Estate Administration Tax jurisdiction.

Summary

If income from an estate is distributed within 36 months, the estate pays a marginal tax rate. If it takes longer than 36 months to close an estate, it is taxed at the highest tax rate.

There are no longer tax benefits to on-going trusts within a Will. Any income not paid out to a beneficiary will be taxed at the highest marginal tax rate.

Regarding the income tax treatment of multiple Wills, as long as the Executor/Trustee of each Will is the same, CRA has declared that, for tax purposes, there is only one trust.

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