O'SULLIVAN

ESTATE LAWYERS

CASE COMMENTARY

Executor denied indemnity by beneficiaries for tax liability

Muth Estate v. Liesch, 2019 ABQB 922

Here is a cautionary tale for executors administering an estate. Canada Revenue Agency (CRA) makes executors personally liable for the estate's final tax return.

Further, executors should not be in a hurry to make distributions from the estate until a tax clearance certificate has been received from CRA.

Finally, it is difficult to try to get money back after it has been distributed to beneficiaries.

The Problem

The estate in question was the executor's husband's estate. The estate was to be divided 55 per cent to the executor and 45 per cent to the nieces and nephews of the deceased.

The executor, the deceased's wife, hired an accountant in 2011 to estimate the tax owning on the final tax return and to also file the return. The first accountant advised that a holdback of $25,000 would be sufficient for all estate income tax liabilities. He did not, however, file the final tax return.

Based on this advice, the executor retained an amount which she thought would be sufficient to pay the income tax obligations of the estate. She then proceeded to distribute the remainder of the estate to herself and the other beneficiaries before she had filed the tax returns for the estate and without having obtained a clearance certificate for the estate from CRA.

The executor then hired a second accountant who advised that the tax liability on the estate was nearly $60,000.

When the executor requested that the beneficiaries pay back part of what she had distributed to them to cover the remaining income tax owing on a proportional basis, several of them refused. The executor was forced to personally pay the income tax liability over the holdback amount she had retained.

She then started a court proceeding to compel the beneficiaries to indemnify her for their shares of the additional income taxes paid.

The Court Decision

Unfortunately, in *Muth Estate v. Liesch* 2019 ABQB 922, the executor was unsuccessful in court.

The judge characterized her failure to obtain a tax clearance certificate before making the distributions to the beneficiaries as a breach of trust and found that the beneficiaries were not required to indemnify her for a breach of trust.

He found that the executor's actions constituted a breach of trust based on the wording of s. 159 of the *Income Tax Act* (Canada), which requires that an executor obtain a clearance certificate before making a distribution from the estate to the beneficiaries and imposes personal liability on the executor for any income tax owing by the estate if the executor fails to do so.

Lessons Learned

1. As a reminder, the *Income Tax Act* makes an executor personally liable for the estate's income taxes, but only if a tax clearance certificate has not been obtained before a distribution is made. Beneficiaries remain liable should income tax liabilities arise after a tax clearance certificate has been obtained by the executor.

2. Executors should be careful and should not be in too much of a hurry to make distributions from the estate to beneficiaries before a tax clearance certificate is obtained. (However, executors also need to be aware that undue delay or unreasonable refusal to make any distributions can be legitimate cause for complaint by beneficiaries.)

3. Depending on the personal relationship existing between the executor and beneficiaries, it can be very hard for an executor to get funds back from beneficiaries after distributions are made if expenses arise for which any holdback the executor still has is insufficient.

   This is true even if beneficiaries specifically agree to do so in writing as part of their approval of a distribution proposal. Pre-existing rancorous relationships and grief can also complicate estate administration and succession matters further.

4. Having to go to court to get indemnification, even if this is successful, is not the ideal outcome for an executor, who could be out of pocket in the interim and will have to pay legal fees as well. Even with a court order,

enforcement on beneficiaries might be difficult, especially if they reside in another jurisdiction.

5. Executors should be very careful when determining a holdback amount, especially where all taxes have not yet been paid or all income tax returns have not yet been filed and assessed.

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