

# ISSUES IN ESTATE ACCOUNTING THAT CAN RESULT IN ESTATE DISPUTES

Anticipating, recognizing, avoiding and responding to issues that arise in Estate Accounting, often on a Passing of Accounts, including a discussion of typical issues that may result in a dispute, if not anticipated and dealt with properly

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# Context of Estate Disputes

- Often it is necessary to understand what has created and shaped an estate dispute, beyond the issues identified in the contest relating to the estate accounting.
- A basic understanding of conflict analysis and its application to estate disputes is useful.
- The context will not only assist in resolving estate disputes, but may aid in anticipating and either avoiding or mitigating estate disputes.

# Conflict Analysis Theory- Five Sources of Conflict

- Emotions – energy fueling a conflict.
- Values – Feelings about what is important or fair.
- Structure – The external framework of the parties.
- History – The historical context or roots of the conflict
- Communications – Faulty communications create and exacerbate conflict.

# Five Sources of Conflict in the Estate Situation

- Emotions – Based both on interactions between the parties as the conflict develops and previous experience. The death of a loved one can release a range of feelings, such as love, hate, guilt, anger and jealousy.
- Values – Each parties' concept of what is fair will help shape their evaluation of each issue. What each party considers to be their “rightful entitlement” will reflect their values.
- Structure – Usually in estate disputes, this is the family. This may encompass several generations and persons from multiple marriages.

# Five Sources of Conflict in the Estate Situation

- History – The historical context of many estate disputes includes the relationship between the beneficiaries and the relationship of each beneficiary and the deceased.
- Communications – Poor communications between the estate trustee and the beneficiaries and between beneficiaries often results in perceptions and positions that are hard to overcome.
- These sources of conflict are often based in the relationships between the parties. An understanding of those relationships can greatly assist in preventing and reducing disputes.

# The Element of Power

- The sources of conflict are all influenced by power.
- In the estate situation, the testator exercised power in the preparation of the will or other estate planning.
- The testator is often a parent and in that relationship with beneficiaries occupied a position of power.

# The Element of Power (2)

- Estate Trustees occupy a position that confers certain power. This may be used and abused and may be resented by others.
- Power or the perception of power can distort the perceptions of those in an estate dispute.
- Power is inextricably intertwined with the relationships of the parties.

# Anticipating Disputes at the Outset

- At the start of estate administration attempt to discover the potential sources of conflicts that may result in an estate dispute.
- Gather information about the parties and their present and past relationships.

# Anticipating Disputes at the Outset (2)

- Review the will and other estate documents, such as designations of beneficiaries to determine potential issues.
  - Who are the estate trustees? Has anyone been excluded who might have been named?
  - Do the primary beneficiaries receive differing entitlements? Why?
  - Has anyone been excluded entirely? Why?
  - Is the relevant will a significant departure from a prior will?
  - Are there assets passing directly to certain beneficiaries? How are they to be valued?
  - Does anyone have the right to obtain an asset? At what value?

# Anticipating Disputes at the Outset (3)

- Emphasize certain requirements or guidelines for the Estate Trustees.
  - The duty to account by the Estate Trustee, including the extent of accounting and transparency.
  - The duty to account is related to the duty to disclose. Lack of disclosure leads to a perception that there are hidden issues and problems.
  - The form of proper financial record keeping. Provide a template for record keeping.
  - The problems of the use of cash transactions or the use of a cash “float”.
  - The need for vouchers for all transactions.
  - The Prudent Investor Rule, or investment requirements set out in the will.

# Anticipating Disputes at the Outset (4)

- Conflicts of interest are to be avoided. These can arise in many contexts.
- Income Tax filings and obligations. Deadlines and requirements.
- Bank statements rather than pass book records.
- Review the various Orders for Assistance that can be obtained by beneficiaries, if accounting is incomplete or not prepared.
- Accounting must start from the date of death for bank accounts and investments, even though the estate trustees do not actually receive funds until later.
- Consider periodic accounting, with or without a formal approval process.

# Prevention of Potential Disputes

- Approvals

- There may be circumstances in which beneficiary approval of an action by the estate trustees, even though within the authority or discretion of the estate trustees, may prevent future disputes. An encroachment on capital might be such a circumstance.
- When the accounts are prepared, careful review may reveal potential issues that may be successfully anticipated and dealt with before they result in actual disputes. Some measure of additional disclosure may reduce the likelihood of disputes.

# Common Issues in Estate Accounting

- Format of the Accounts
  - Where the accounts are to be passed by the court they must be in the form as set out in the Rules of Civil Procedure.
  - The format for estates is not the same as that for normal business accounting.
  - Ensure that the preparer of the accounts is equipped to prepare accounts in the proper form.
  - Even informal accounts, not for court passing, should have most of the elements or components of formal accounts.
  - There must be a separate account for investments.

# Common Issues in Estate Accounting (2)

- Valuations

- There are a number of types of valuations that may give rise to disputes in an estate. These include:
  - Values of assets transferred to beneficiaries in specie.
  - Values of substantial assets sold, such as real estate.
- It is essential to have reliable appraisals of assets.
- Valuations should be contemporaneous with the disposition of the asset.
- Accurate valuations at the date of death are also necessary for the Estate Information Return.

# Common Issues in Estate Accounting (3)

- Capital and Revenue

- Allocations of revenue and disbursements between capital and revenue must be proper, especially where the capital and income beneficiaries are not the same.
- An “even hand” must be maintained between capital and income beneficiaries. The reality or perception of this is difficult in cases where estate trustees are also beneficiaries.
- Accrued interest to the date of death is a capital receipt.
- Dividends declared, but not paid prior to the date of death, ( x-dividends) are capital receipts.

# Common Issues in Estate Accounting (4)

- Transfers in specie will produce a capital receipt and a capital disbursement.
- Purchases of investments are not capital receipts. They are recorded in the investment account.
- Some types of receipts such as a blended mortgage payment will have a capital and a revenue component.
- Some expenses such as insurance on real property and repairs may have a capital and a revenue component.

# Common Issues in Estate Accounting (5)

- Estate Trustees' Compensation
  - This is perhaps the most litigated, or contested facet of estate administration.
  - Beneficiaries who are unhappy with the administration of the estate for any number of reasons, including delays in distribution, dissatisfaction with amounts received for assets, income returns, or personal conflict with the estate trustees, may seize on the compensation calculation as a tool to exact some measure of revenge or perceived justice from the estate trustees
  - The right to compensation is provided for by statute (*Trustee Act*), but is not defined beyond the terms "fair and reasonable".
  - The manner of calculating compensation may be set out in the will, or in a separate agreement.

# Common Issues in Estate Accounting (6)

- The use of the “usual formula”, must be measured against the “5 factors”, to determine if compensation is, in fact, fair and reasonable.
- Pre-taking compensation before approval of the beneficiaries or the court, may result in a requirement to pay interest on the amount pre-paid.
- The calculation of the care and management fee must be clearly shown in the accounts, including information as to the value of amounts under administration at the beginning and end of each estate year. No care and management fee should be charged for the first year of estate administration.
- Compensation on a percentage basis may be reduced for assets of particularly large value as measured against the effort involved in dealing with such assets and the five factors generally.

# Common Issues in Estate Accounting (7)

- Agents and professional fees may in some instances not be subject to compensation and in some instances may be deducted from compensation, where the services are reasonably within the duties of an estate trustee.
- Transfers to and from trusts should not be subject to compensation.
- Encumbrances on land should be deducted when calculating compensation.
- Transfers in specie may be subject to reduced compensation.

# Common Issues in Estate Accounting (8)

- Legal fees charged for services that are properly the duties of estate trustees' may be charged to the estate, but then should be deducted from compensation, or should be charged to the estate trustees.
- When a lawyer is estate trustee, the services in both capacities should be clearly separated and charged accordingly.
- Penalties and interest charges relating to matter such as late Income Tax filings, may be deducted from compensation.
- No compensation should be charged on capital losses.

# Common Issues in Estate Accounting (9)

- Compensation should not be charged on reimbursements to estate trustees.
- Compensation should not be charged on a flat percentage basis (e.g. 5% on all receipts and disbursements)
- Compensation should not be charged on the disbursement of compensation from previous periods, the period covered by the present accounting or the final payment of compensation.

# Common Issues in Estate Accounting (10)

- Other Issues that may result in disputes
  - Assets sold to non-arm's length parties
  - Private corporations with insufficient details in the accounting
  - Joint assets that may not have passed by survivorship
  - Late payment of legacies
  - Capital encroachments not properly authorized

# Common Issues in Estate Accounting (11)

- Loans to family members
- Overpayments of income
- Missing vouchers
- Accounts that do not balance
- Investments not in accordance with the will
- Legal and accounting fees with insufficient detail

# Common Issues in Estate Accounting (11)

- Corporate distributions – allocation to capital or revenue
- Income Tax elections not exercised
- Income tax deductions and credits not claimed
- Interest and penalties on late payments or filings of Income Tax
- Interest on late payments of legacies
- Delay in administration

# Tips When the Accounts Don't Balance

- Determine the exact amount that is the difference between the capital and revenue balance and the total of investments and cash.
- If the difference is divisible by 2 a receipt may have been recorded as a disbursement or a disbursement may have been recorded as a receipt.
- If the difference is divisible by 9, a transposition of figures in an amount may have occurred (i.e. 63 recorded as 36).
- An entry may have been omitted. Check recurring entries.
- Consider reconciling and balancing each component of the accounts independently, such as a bank account, brokerage account and lawyer's trust account.

# Contested Passing of Accounts

- Three possible processes
  - Negotiation
  - Litigation
  - Mediation

# Negotiation

- Once it is apparent that a Passing of Accounts is likely to be contested, negotiation should be considered.
- Additional information provided to the disputing party may be sufficient to settle the matter.
- Negotiation may be useful at any stage of the process, right up to the issuance of a judgement.
- Ensure that all necessary parties consent to any negotiated settlement.

# Litigation

- Accounts in an estate may be passed voluntarily or on a compulsory basis, as perhaps provided for in an Order for Assistance.
- In either case, the Passing of Accounts may be on a contested basis.
- The process and timelines are set out in the Rules of Civil Procedure and should be monitored and followed.

## Litigation (2)

- Particularly note the time for Notices of Objection.
- Respond promptly and completely to each Objection.
- It is often possible to respond to each Objection in a manner, such as providing more information as to a specific entry in the accounts, and obtain the withdrawal of the Objection.

# Mediation

- Mediation is a process involving a neutral facilitator who will attempt to assist the parties to resolve or settle issues in dispute. The mediator is not an adjudicator. The mediator does not determine issues.
- Potential advantages of mediation.
  - Reduced costs.
  - Reduced time.
  - Possibility of settlement on terms that a court could not provide.
  - “Win-win” results.
  - Reduced damage to relationships.

# Mediation (2)

- Mandatory mediation

- In Toronto, Ottawa and Windsor issues on a contested passing of accounts are subject to mandatory mediation.
- The time required for mandatory mediation is very limited.
- Often the parties, or their counsel, are not committed to the mediation process, so success is not likely.

- Court ordered mediation

- The court may order the parties to attend mediation.
- The order may specify the issues to be mediated, the time frame and the mediator.
- The parties may have requested that mediation be ordered. This enhances the probability of success.

# Mediation (3)

- Voluntary mediation
  - The parties may agree to mediation independently of the court .
  - This may occur at any stage of the matter, even before formal litigation has commenced.
  - Again, as this is a process that the parties commit to, the prospect of success is enhanced.
- At what stage should mediation occur?
  - Some counsel prefer to wait until all discoveries have occurred and all documents produced.
  - Some counsel will choose an earlier stage of proceedings for mediation.
  - Sometimes successful mediation can occur even before litigation.

# Mediation (4)

- Choice of a mediator
  - Skills required include the ability to assess the parties and their relationships, determine the real issues driving the conflict and the ability to suggest creative solutions that may address more than just the bare issues.
  - Expertise in the area of estates law is not necessary, but often assists in defining the issues for the parties and crafting a settlement.
- The mediation brief
  - This is the essential document in the mediation process and may be critical to the success of the mediation.
  - The issues should be clearly and concisely set out.
  - Any relevant documents, such as pleadings and orders, should be included.
  - The brief should be delivered at least one week before the mediation.

# Conclusion

- In order to prevent or successfully deal with disputes arising from estate accounting:
  - Prepare – At every stage of the process
  - Anticipate - Potential issues
  - Disclose – Information as fully as possible
  - Negotiate – To settle disputes