Update on Recent Trust Tax Changes and Planning Opportunities

Toolbox Seminar

March 3, 2016

Presented by:
Lorne Saltman

GARDINER ROBERTS

GARDINER ROBERTS

Topics to Discuss

- Changes to Subsection 75(2) for resident and non-resident trusts
- Demise of the 5-year immigration trust
- Testamentary trusts and graduated rate estate
- Life interest trusts
- Philanthropic planning with trusts
- Residence of trusts – recent cases
- Rectification and trusts

GARDINER ROBERTS

Non-Resident Trusts and ss. 75(2)

after *Sommerer v. The Queen*, 2012 DTC 5126 (FCA)

- Despite long-standing CRA policy that ss. 75(2) applied not only a to gift but also a sale at FMV by a person to a family trust, Federal Court of Appeal held in *Sommerer* that 75(2) does not apply to a sale at FMV
- 75(2) amended in 2013 to be limited to a trust that is resident in Canada

GARDINER ROBERTS

Non-Resident Trusts and ss. 75(2)

after *Sommerer v. The Queen*, 2012 DTC 5126 (FCA)
…cont'd

- 94(8.1) uses familiar "reversionary" wording of old 75(2) to trigger application of NRT rules under 94(3) to deem a non-resident trust to be resident in Canada for certain purposes under the *Income Tax Act*

GARDINER ROBERTS

Demise of 5-Year Immigration Trust

- Consider remaining opportunity
- NRT tax rate going up from current 42.92% (as compared with top tax rate for Ontario resident individual at 49.53%) to 46.92% (as compared with 53.53%)

GARDINER ROBERTS

Testamentary Trusts and Graduated Rate Estate

- The Federal government views as abusive the use of multiple testamentary trusts to split income among family member trusts, and introduced rules starting in 2016 to tax testamentary trusts at the highest personal rate in the same way as are *inter vivos* trusts. i.e. 53.53% in Ontario

GARDINER ROBERTS

Testamentary Trusts and Graduated Rate Estate …cont'd

- There are two important exceptions to the new rules:
  - a **Graduated Rate Estate**, one that arose on, and as a consequence of, an individual's death, that can utilize the graduated marginal rates for the first 36 months after death; and
  - a **Qualified Disability Trust**, a testamentary trust in respect of which the beneficiary who is disabled and qualifies for the Federal disability tax credit, jointly elects with the trustee to have the trust qualify to be taxed at the graduated marginal rates.
- Given that a deceased can now have only one GRE for income tax purposes, current estates with testamentary insurance trusts, spousal trusts or other family trusts should be reviewed and updated.

GARDINER ROBERTS

Life Interest Trusts

- The new rules starting in 2016 are applicable to spousal trusts, *alter ego* trusts, joint spousal trusts and joint common-law partner trusts ("life interest trusts").
- When the individual with the life interest dies (such as the spouse in a spousal trust), the trust is liable for the tax on death.
- The testamentary spousal trust will not qualify for marginal rate treatment

GARDINER ROBERTS

Philanthropic Planning With Trusts After 2015 – Estate Donations

- Charitable donations can be made in a Will, so that the personal tax credit can be claimed to offset tax payable by the individual deceased or the resulting estate
- New rules deem the gift to be made by the estate when the property is actually transferred to the charity- valuation must be done at that time, even though the deemed disposition of the deceased's assets occurred at death

GARDINER ROBERTS

Philanthropic Planning With Trusts After 2015 – Estate Donations …cont'd

- For gifts made by a GRE, the donation may be claimed in any of (a) the taxation year of the estate in which the donation is made, (b) an earlier taxation year of the estate, (c) any of the following five taxation years of the estate, or (d) the last two taxation years of the deceased

GARDINER ROBERTS

Philanthropic Planning With Trusts After 2015 – Estate Donations …cont'd

- If the estate is a GRE at the time the gifted property is transferred to a qualified donee (generally, a registered Canadian charity) and the gift comprises publicly-listed securities, an ecological gift or a cultural gift, the deceased will realize a capital gain of nil on the deemed disposition of the property on death, and the estate will realize a capital gain of nil on the actual disposition of the property to the donee.

GARDINER ROBERTS

Discovery Trust and Boettger Cases, Re: Residence of a Trust for Provincial Tax Purposes

- In the last several years, it has been common for trusts to be established in Alberta by individuals in the high-rate provinces, in order to shift income and capital gains to take advantage of the lower provincial tax rate in Alberta
- "As with corporations, residence of a trust should be determined by the principle that a trust resides for purposes of the Act where 'its real business is carried on' … which is where the central management and control of the trust actually takes place." (Garron case)

GARDINER ROBERTS

Discovery Trust and Boettger Cases, Re: Residence of a Trust for Provincial Tax Purposes …cont'd

- The Minister of National Revenue has lately been auditing many trusts and challenging their entitlement to the lower tax rate, on the basis of the test for "residence", in order to protect the tax base of the higher-rate provinces

GARDINER ROBERTS

Discovery Trust and Boettger Cases, Re: Residence of a Trust for Provincial Tax Purposes …cont'd

- In *Discovery Trust*, the taxpayer was successful in demonstrating that the trust was resident in Alberta and not in Newfoundland
- In *Boettger*, the Minister of National Revenue was successful in demonstrating that the trust was resident in Québec and not in Alberta

GARDINER ROBERTS

Discovery Trust and Boettger Cases, Re: Residence of a Trust for Provincial Tax Purposes …cont'd

While it is difficult to reconcile these two cases, there are some lessons to be gleaned from the reports.

- **First**, the substance of who exercises central management and control of the trust must follow the customary procedures and commercial practises in favour of the trustee acting with independence.

GARDINER ROBERTS

Discovery Trust and Boettger Cases, Re: Residence of a Trust for Provincial Tax Purposes …cont'd

- **Second**, the settlor of a trust must recognize the trade-off between giving up control and benefitting from the conferral of sufficient independent powers on the trustee to defeat an argument that the settlor has, in fact, never given up control.
- **Finally**, the documents and correspondence reflecting the planning and implementation of a trust arrangement should be carefully crafted to be consistent with the usual non-tax purposes (such as estate planning) as well as the tax purposes for establishing the trust.

GARDINER ROBERTS

Rectification and Trusts

- When a tax-related error is made in relation to a trust, it may be possible to apply for an order from the civil courts to rectify the relevant documents to be consistent with the original intention of using the trust, and thus avoid the adverse tax consequences

GARDINER ROBERTS

Rectification and Trusts

Canada (Attorney General) v. Brogan Family Trust 2104 ONSC 6354 (OSCJ)

- The CRA and the Department of Justice have expressed dissatisfaction and concern with the result in this case.
- The Ontario Superior Court of Justice held that CRA need not be served with notice of a rectification application to add minor beneficiaries inadvertently omitted from a family trust deed. Subsequently, tax on the capital gain on the sale of trust property was allocated to the added minor beneficiaries:
  - " the CRA is only required to be given notice of a proposed rectification proceeding when the CRA's legal interests might be directly affected by the outcome of the rectification proceeding, such as where the CRA is a creditor and the rectification would affect its rights…" (paragraph 22)

GARDINER ROBERTS

This information has been presented to you courtesy of **Gardiner Roberts LLP** as a service for our clients and other persons dealing with tax and estates issues. It is not intended to be a complete statement of the law or an opinion on any subject. Although we endeavour to ensure its accuracy, no one should act upon it without obtaining proper legal advice, following a thorough examination of the facts of a specific situation and the applicable law.

GARDINER ROBERTS

This information has been presented to you courtesy of **Gardiner Roberts LLP** as a service for our clients and other persons dealing with tax and estates issues. It is not intended to be a complete statement of the law or an opinion on any subject. Although we endeavour to ensure its accuracy, no one should act upon it without obtaining proper legal advice, following a thorough examination of the facts of a specific situation and the applicable law.