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Dear Ms. Gwyer,

RE: Advocating for Greater Tax Neutrality for Life Interest Trusts Under the Income Tax Act

Through the joint work of the Public Policy Committee and the Tax Technical Committee, STEP Canada is making this submission to the Department of Finance Canada concerning the unequal tax treatment of life interest trusts compared to property held directly by individuals under the *Income Tax Act* ("the Act").

Life interest trusts are recognized will substitutes that remain subject to tax on accrued gains through the deemed disposition rules in subsection 104(4). Numerous death-related provisions nonetheless produce materially different outcomes solely because property is held in a life interest trust rather than personally, frequently resulting in double taxation, stranded tax attributes, unnecessary complexity, or impediments to ordinary estate planning.

STEP Canada respectfully recommends amendments that would provide greater tax neutrality for qualifying life interest trusts, including the introduction of a deemed graduated rate estate regime and related measures to reduce unintended disparities in tax outcomes.

We would like to acknowledge the contributions of the following subcommittee members for their assistance in preparing this submission: Kenneth Keung, Amanda Doucette, Ian Lebane, Henry Shew, Harmanjit Mavi, Pam Prior, and Pamela Cross. We would also like to thank CALU for their collaboration and contribution to this submission.

We would be pleased to discuss this submission further or provide additional technical input as required.

Kindly direct any enquiries to Michael Dodick, Chief Operating Officer, at mdodick@step.ca.

Yours truly,

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Executive Summary

Under the principle of tax neutrality, property held personally and property held through a qualifying life interest trust should generally receive the same tax treatment unless a clear policy rationale justifies a different result. That principle should extend beyond death to ensure comparable treatment of property administered through a deceased individual's estate and property held in a qualifying life interest trust following the death of the life interest beneficiary. Although life interest trusts are recognized will substitutes that remain subject to tax on accrued gains through the deemed disposition rules under subsection 104(4) of the *Income Tax Act* ("the Act"), numerous provisions relating to post mortem loss utilization, charitable giving, life insurance funding, and other death-related tax rules produce materially different outcomes when property is held in a life interest trust rather than personally. These differences frequently result in double taxation, stranded tax attributes, unnecessary complexity, or impediments to ordinary estate planning.

The Act allows property to be transferred to a life interest trust on a tax-deferred basis, without the immediate recognition of accrued gains. In exchange for providing rollover treatment, Parliament ensured that accrued gains remain attributable to the life interest beneficiaries and are ultimately recognized through a death-triggered realization event. However, a combination of legislative developments, relieving provisions specific to graduated rate estates (GREs), and administrative interpretations has created significant disparities between property held in life interest trusts and property owned personally. As a result, taxpayers who use life interest trusts for entirely non-tax reasons, including incapacity planning, probate management, privacy, succession planning, and protection of vulnerable beneficiaries, often face greater tax liability, less flexibility, and more complexity than taxpayers who retain personal ownership until death.

In light of the differential treatment of life interest trusts identified in this submission, STEP Canada respectfully recommends that the Department of Finance create a "post mortem deemed GRE" regime for qualifying life interest trusts and consider related amendments to ensure the consistent tax treatment of property held personally and property held in a qualifying life interest trust.

PART 1: LIFE INTEREST TRUSTS ARE WILL SUBSTITUTES, NOT TAX-AVOIDANCE VEHICLES

This submission concerns the principal categories of life interest trusts recognized under the *Income Tax Act* ("the Act"), namely:

- self-benefit trusts,
- alter ego trusts,
- joint spousal or common-law partner trusts,
- *inter vivos* spousal or common-law partner trusts, and
- testamentary spousal or common-law partner trusts.

Life interest trusts are widely used for many non-tax purposes, including privacy, incapacity planning, facilitating estate administration and simplifying the transfer of property on death, ensuring continuity of asset management, and planning for blended families or disabled beneficiaries.

The life interest trust regime under the Act reflects a longstanding legislative policy of permitting taxpayers to transfer property to certain qualifying trusts without triggering an immediate realization of accrued gains, while ensuring that those gains remain subject to tax at a later time. The rules governing spousal trusts have existed in various forms for decades, while the alter ego, joint partner, and self-benefit trust regimes were introduced in 2000 as part of a broader expansion of rollover opportunities for certain personal trusts.

The Act generally allows property to be transferred to qualifying life interest trusts on a tax-deferred basis, without the immediate recognition of accrued gains. In exchange for this favourable rollover treatment, Parliament imposed strict conditions. Throughout the relevant lifetime period, entitlement to the trust's income must be limited exclusively to the specified life beneficiary or beneficiary couple—that is, the contributing taxpayer (or his or her estate) and/or, in the case of joint spousal and common-law partner trusts, his or her spouse or common-law partner. In addition, no other person may, before the relevant death event, receive or otherwise obtain the use of any income or capital of the trust. These restrictions are fundamental conditions of qualification for the rollover and are common features of the life interest trust regime.

Rollover treatment does not eliminate the tax on accrued gains; rather, it defers that taxation. The deferred tax liability is preserved through subsection 104(4), which generally deems qualifying life interest trusts to dispose of their property at fair market value on the death of the relevant life beneficiary or, in the case of a joint spousal or common-law partner trust, on the death of the survivor of the two beneficiaries. In this respect, the deemed disposition generally occurs upon the same death event, and in respect of the same accrued gains, that would have triggered taxation had the property remained personally owned. The statutory restrictions on access to trust income and capital before the relevant death event form an integral part of this legislative bargain underlying this rollover treatment and help ensure that the same tax base remains subject to tax.

Life interest trusts are also not intended to provide income tax advantages over personal ownership during the lifetime of the relevant life beneficiary. Unlike individuals and graduated rate estates ("GREs"), income retained in life interest trusts is taxed at the top marginal tax rate. In addition, the statutory conditions applicable to life interest trusts generally require that trust income be payable only to the relevant life beneficiary or beneficiary couple. The attribution rules set out in subsections 75(2), 74.1, and 74.2 further prevent any inappropriate shifting of income, taxable capital gains, and allowable capital losses between a taxpayer and his or her spouse or common-law partner while both are alive.

Prior to 2016, testamentary trusts generally benefited from graduated rate taxation and certain other tax attributes available to individuals. As part of the reforms effective January 1, 2016 ("the GRE reforms"), Parliament restricted many of these benefits to a deceased individual's GRE for a period of 36 months following death. The policy concern underlying these reforms was primarily the multiplication of graduated tax brackets and other benefits through the use of multiple testamentary trusts. Life interest trusts were not the focus of the GRE reforms. Nevertheless, the GRE reforms contributed to some of the differences in tax treatment that now exist between property held in life interest trusts and property owned personally or administered through a GRE. Many other differences, however, predate the GRE reforms and arise from provisions that were historically designed around the concept of a deceased individual's estate, without corresponding consideration of life interest trusts. Regardless of when particular differences arose, the key question is whether those distinctions continue to serve a valid policy objective where a life interest trust has been subject to a death-triggered realization event under subsection 104(4).

From an income tax perspective, whether capital property is held personally or through a qualifying life interest trust, accrued gains are generally brought into the tax system as a consequence of a deemed disposition at death before the property passes to beneficiaries (other than where a spousal or common-law partner rollover applies). The principal distinction is therefore the legal vehicle through which the property is held prior to death. This functional equivalence underlies the policy concerns discussed throughout this submission. From a policy perspective, beneficiaries should generally receive the same after-tax value from property with the same accrued gain, regardless of whether the property was held personally or through a qualifying life interest trust.

PART 2: TAX DISPARITIES BETWEEN LIFE INTEREST TRUSTS AND GRADUATED RATE ESTATES

Part 1 of this submission established that both personal ownership and life interest trusts generally result in a death-triggered realization event. This part summarizes the principal differences in tax treatment between property held personally and property held through a life interest trust. Although the focus is primarily on death-related tax consequences, certain disparities arising during the lifetime of the taxpayer will also be noted.

A. Tax rate and timing of tax payments differences

Graduated rates	On the death of an individual taxpayer, the deemed capital gains arising on death under subsection 70(5) are taxed at graduated rates, and following death there is an opportunity to establish a GRE for up to 36 months. In contrast, life interest trusts are subject to the top marginal rates both on gains arising from the deemed disposition upon the death of the life interest beneficiary and on income throughout the post-death period.
Alternative minimum tax (AMT)	A GRE is exempt from AMT pursuant to paragraph 127.55(f). In contrast, life interest trusts, like individual taxpayers, are subject to AMT (apart from a narrow carve-out for deemed dispositions in the year of death), but, unlike individuals, cannot access the basic indexed *de minimis* exemption. This issue is most commonly encountered with testamentary spousal trusts and joint spousal or common-law partner trusts following the death of the settlor.
Taxation year-end	A GRE has the flexibility to adopt a non-calendar year-end to access the benefits of GRE status for a full 36 months after death. In contrast, life interest trusts, pursuant to paragraph 249(1)(c), are required to have a December 31 year-end.
Deferral of tax on death	Where an individual dies owning property personally, a GRE's legal representative may elect under subsection 159(5) to pay the tax on deemed disposition gains in up to 10 annual instalments. In contrast, no comparable relief exists where the tax arises from the deemed disposition of property held in a life interest trust on the death of the life interest beneficiary under subsection 104(4).
Instalment requirements	A GRE is exempt from the requirement to remit instalments pursuant to subsection 156.1(2). In contrast, instalments are technically required for all life interest trusts, although the current administrative practice of the Canada Revenue Agency (CRA) is not to assess penalties or interest where an estate or trust fails to make instalments).

B. Charitable giving differences

Treatment of bequests	A GRE can treat a fixed entitlement to a registered charity beneficiary of an estate as a donation and claim a tax credit. In contrast, such a "donation" in a life interest trust is treated as a capital distribution. To claim a donation tax credit, the trust deed must be drafted to give the trustee the discretion to make (or not make) the charitable gift, which may not be desirable from an estate-planning perspective.

Period for making donations	A GRE has 60 months from the date of death of the individual to make a gift to a registered charity and claim a tax credit. In contrast, a life interest trust must gift property within 90 days after December 31 of the year of death of the particular life interest beneficiary to be able to claim the tax credit against the deemed capital gain under subsection 104(4).
Flexibility in claiming credits by the deceased	A GRE has the discretion to claim donation tax credits in the deceased's terminal return or the immediately prior year. In contrast, donations by a life interest trust cannot be allocated to the deceased beneficiary.
Income limit for donations	Donations claimed by a GRE in the terminal return and the immediately prior year can be claimed at 100% of net income. In contrast, donations claimed by a life interest trust are limited to 75% of net income.
In-kind donations	A GRE is entitled to the 0% capital gain inclusion rate on in-kind donations of publicly traded securities, both on the accrued capital gain at the date of death and on any appreciation from the date of death to the date of gift. In contrast, a life interest trust is not entitled to this preferential treatment on accrued gains subject to taxation under subsection 104(4), but only on any appreciation from the date of death. Similar disparity exists for gifts of ecologically sensitive property.

C. Post mortem double taxation relief differences

Interaction of subsection 164(6) and subsection 111(2)	A GRE's legal representative may elect under subsection 164(6) to treat eligible capital losses realized during the estate's first three taxation years as losses of the deceased in the terminal year. Through its interaction with subsection 111(2), the resulting net capital loss may, subject to statutory limits, be applied against the deceased's income from any source—not merely against capital gains. This provides meaningful relief from post mortem double taxation. In contrast, while a life interest trust may generally carry back its own net capital losses for up to three years under paragraph 111(1)(b), those losses remain losses of the trust and generally may be applied only against capital gains. Because subsection 164(6) cannot treat the losses of a life interest trust as losses of the deceased beneficiary, the trust cannot access the broader subsection 111(2) terminal-year treatment. The same economic loss may therefore provide substantially greater tax relief when the property is held in a GRE.
Interaction of subsection 164(6) and subsections 40(3.6) and (3.61)	Subsection 40(3.6) generally deems a loss on a share redemption by an affiliated corporation to be nil. Subsection 40(3.61) provides targeted relief where a GRE elects under subsection 164(6) to carry back a capital loss from a share disposition: the elected portion is preserved for carryback to the deceased's terminal year, while subsection 40(3.6) applies only to any loss remaining in the estate after the election. This coordination allows the estate to use the redemption loss to offset the deceased's terminal-year gain and mitigate shareholder-level double taxation. In contrast, no equivalent relief for life interest trusts is available under subsection 40(3.61).

Section 88 bump availability	Where control of a corporation is acquired through an acquisition of shares as a consequence of an individual's death, paragraph 88(1)(d.3) deems the acquiror to have acquired control from a person dealing at arm's length for the purposes of the bump rules. This establishes the relevant valuation date for a paragraph 88(1)(d) bump and can mitigate the mismatch between the increased adjusted cost base of shares arising on death and the historic tax cost of the corporation's underlying assets. However, paragraph 88(1)(d.3) does not address the situation where shares remain held by a life interest trust and are merely deemed disposed of and reacquired under subsection 104(4). In that case, the death of the relevant life interest beneficiary may not result in an acquisition of control because the trustee remains the legal owner of the shares before and after the beneficiary's death.
Subsection 40(3.12) carryback	Subsection 40(3.12) permits a corporation, an individual other than a trust, or a GRE to elect a capital loss on a partnership interest, limited by the interest's adjusted cost base and prior subsection 40(3.1) deemed gains. In contrast, a life interest trust is excluded from subsection 40(3.12) because it is a trust.

D. Qualified small business corporation (QSBC) shares and qualified farm or fishing property (QFFP) differences

Capital gain deduction	When an individual dies, they are deemed to have disposed of directly owned QSBC or QFFP shares immediately before death, which allows the lifetime capital gains exemption (LCGE) under section 110.6 to be claimed on the individual's terminal tax return. In contrast, if QSBC or QFFP shares are held within a life interest trust, the beneficiary's death triggers a deemed disposition inside the trust at fair market value under paragraph 104(4)(a). Because trusts cannot claim the LCGE and are precluded from allocating deemed gains under paragraph 104(6)(b) on a life interest beneficiary's death, the life interest trust cannot utilize a subsection 104(21.2) designation, rendering the exemption unavailable to shelter the tax liability.
Farm rollovers	Under subsection 70(9.2), a tax-deferred rollover is available where shares of a family farm or fishing corporation, or an interest in a family farm or fishing partnership, are transferred directly to a child on the taxpayer's death. Subsections 70(9.1) and 70(9.3) provide parallel rollover rules for property held in trust, but these provisions apply strictly to spousal or common-law partner trusts (*inter vivos* or testamentary). Because alter ego trusts and joint partner trusts fall outside the scope of subsections 70(9.1) and 70(9.3) (as indicated by provisions' qualification of "subsection 73(1), they are ineligible for this tax-deferred rollover. Consequently, the death of the life interest beneficiary triggers a deemed disposition at fair market value under paragraph 104(4)(a), preventing the rollover that is available when farming or fishing property is held directly.

E. Cross-border differences

Part XII.2 tax	Part XII.2 imposes a tax on trusts that earn Canadian real estate or business income ("designated income") and allocate it to non-residents ("designated beneficiaries"). Its primary purpose is to prevent non-residents from using Canadian trusts to avoid Part I tax rates on Canadian-source income. A GRE is explicitly exempt from Part XII.2 tax under subsection 210(2). In contrast, life interest trusts are not exempt and remain subject to the tax.

Foreign tax credits	Most life interest trusts are subject to subsection 75(2), with foreign-source income often attributed to the settlor. However, foreign taxes paid by the trust are generally not attributed to the settlor, preventing the settlor from claiming a foreign tax credit or deductions under subsections 20(11) or 20(12) in respect of the attributed income. This results in double taxation.
US estate tax and foreign tax credits	US citizens and domiciliaries are subject to US estate tax on their worldwide assets. Under article XXIX B(6)(a) of the Canada-US tax treaty, US estate taxes paid in respect of US-situs property can generally be claimed as a foreign tax credit against Canadian terminal federal tax on gains from that property. However, if a US person transfers assets to a life interest trust, the US estate tax may still apply at death under US grantor/retained interest rules. Because the Canadian deemed disposition on death under subsection 104(4) occurs inside the trust rather than on the beneficiary's terminal tax year, the mismatch in taxpayers (the trust versus the deceased individual) prevents the foreign tax credit from offsetting the dual tax liabilities.

F. Other technical and administrative differences

T3 filing obligations under paragraph 150(1.2)(j)	Under paragraph 150(1)(c), estates and trusts are required to file a T3 return within 90 days from the end of the year. Subsection 150(1.1) provides an exception under which a trust is not required to file a T3 return for a taxation year if it has no tax payable, taxable capital gain, or disposition of capital property. Subsection 150(1.2) further provides that the potential exemption from the T3 filing obligation under subsection 150(1.1) does not apply to express trusts, unless they are listed in paragraphs 150(1.2)(a) to (r). A GRE is a "listed trust" pursuant to paragraph 150(1.2)(j) and may therefore benefit from a potential exemption from the T3 filing obligation under subsection 150(1.1). In contrast, life interest trusts do not fall under any of the specified exemptions listed in paragraphs 150(1.2)(a) to (r). As a result, life interest trusts may never benefit from the T3 filing exemption under subsection 150(1.1). Consequently, life interest trusts must bear the administrative burden associated with trust reporting requirements and face potential penalties for non-compliance.
Spousal rollovers	On the death of an individual taxpayer, subsection 70(5) generally deems the taxpayer to have disposed of his or her capital property at fair market value immediately before death, resulting in the taxation of any accrued gains in the deceased's terminal return. However, where the requirements of subsection 70(6) are met, a rollover is available in respect of property transferred through a GRE to a surviving spouse or qualifying spousal trust, thereby deferring the subsection 70(5) deemed disposition until the surviving spouse's death. In contrast, no spousal rollover is available on death for property held in an alter ego trust or self-benefit trust, even if the property ultimately forms part of the estate and is distributed to the spouse under the will. Transfers of property to an alter ego trust or self-benefit trust are listed as qualifying transfers under subparagraph 73(1.1)(c)(i). Alter ego trusts and self-benefit trusts described in subparagraph 73(1.1)(c)(i) are subject to the deemed disposition rule under clause 104(4)(a)(iv)(A), which provides that the trust is deemed to dispose of its property at fair market value on the settlor's death, resulting in the taxation of any accrued gains at that time. The lack of a tax-deferred rollover to a spouse is particularly concerning in the context of self-benefit blind trusts (which are often used to address conflict of interest concerns for elected politicians, senior public servants and others) who are required to use these trusts by law.

Notices of objection	Subsection 165(1) establishes the limitation periods within which a taxpayer may file a notice of objection to an assessment. A GRE may file a notice of objection on or before the later of (1) one year after the filing-due date for the year under subparagraph 165(1)(a)(i), and (2) 90 days after the notice of assessment is sent under subparagraph 165(1)(a)(ii). In contrast, the extended deadline to file a notice of objection under subparagraph 165(1)(a)(i) is unavailable to life interest trusts. Pursuant to paragraph 165(1)(b), life interest trusts must file a notice of objection within 90 days after the notice of assessment is sent. As a result, life interest trusts may have a substantially shorter period within which to challenge assessments than a GRE.
Taxpayer relief	Subsection 152(4) generally prevents the Minister from reassessing an income tax return for a taxation year that is more than three years after the date of the original notice of assessment or of an original notification that no tax was payable for the year. Subsection 152(4.2) gives the Minister the authority to make a reassessment or a redetermination beyond the normal reassessment period for a statute-barred taxation year, when requested by an individual (other than a trust) or a GRE, in order to determine a refund or to reduce tax payable. The individual or GRE has 10 years from the end of a calendar year in which the taxation year or fiscal period at issue ended to make a request for relief under subsection 152(4.2). In contrast, life interest trusts are excluded from subsection 152(4.2), and thus cannot benefit from the extended 10-year period.
Transfers of residences	An individual (or two individuals who are spouses or common-law partners) who owns two residential properties (for example, a city home and a cottage) may defer making the principal residence designation on either property until the eventual disposition of one of the properties. At that time, the chosen property may be designated as a principal residence for the years during which it was owned (and no other property was so designated). In contrast, when an individual transfers one or more qualifying residential properties into a life interest trust under subsection 73(1), a disposition occurs within the meaning of "disposition" in subsection 248(1). For the trust to benefit from the principal residence exemption, subparagraph 40(4)(b)(ii) requires the property to have been designated the transferor's principal residence at the time of the initial transfer. Therefore, to preserve the principal residence exemption for the trust, the transferor is required to make a principal residence designation in respect of the years prior to the transfer in the transferor's return of income for the taxation year in which the subsection 73(1) transfer occurs. As a result, transferring one or more properties that *could* qualify for the principal residence exemption to a life interest trust can accelerate principal residence decisions that may ultimately be detrimental to the taxpayer. No similarly early decision is generally required where the property is retained personally or transferred to a spouse on a rollover basis.

PART 3: LIFE INSURANCE ISSUES AFFECTING LIFE INTEREST TRUSTS

The life insurance portion of this submission was prepared by the Conference for Advanced Life Underwriting (CALU). We are pleased to include CALU's comments and recommendations in support of the issues addressed in this submission.

Life insurance can be an important asset in a trust for the following reasons, among others:

- Life insurance provides money at death for the trustee to use to pay taxes and/or provide funds to carry out the terms of a buy-sell agreement.
- Trust ownership of a life insurance policy helps ensure that the policy will remain in force until the life insured person's death, and that the proceeds of insurance will be managed according to the settlor's wishes, as expressed in the trust document.
- A trust is less vulnerable to attack from disgruntled heirs than a will. Nor is it as vulnerable to claims under dependant's relief and family law legislation.
- Trust ownership can help protect the proceeds of insurance from probate and/or claims of the deceased's creditors.
- Trust ownership can help ease any inequities that may arise when a deceased's assets pass to heirs through different mechanisms. Those mechanisms include a will, personally owned life insurance and segregated fund beneficiary designations, joint ownership with right of survivorship, and/or buy-sell agreements. Some of those transfers may trigger tax obligations; others may be tax-free. The process of distributing wealth through different mechanisms may unintentionally disadvantage some heirs. A properly worded trust enables the trustee to use the proceeds of insurance to help ease any inequities that may arise.

These uses of life insurance apply equally to life interest trusts and other types of trusts. Further, life insurance in a life interest trust can fund the needs of the trust, just as it can when it is owned in other types of trusts. With a trust of any kind, the optimal structure for life insurance is for the trust to own and pay premiums for the policy, and for the trustee to receive the death benefit.

However, the CRA has stated that the income and assets of a life interest trust cannot benefit or be made available for the use of anyone other than the trust's lifetime beneficiaries (for example, see CRA Folio S6-F4-C1, paragraph 1.33). According to CRA guidance, life insurance owned by a life interest trust taints the trust by using trust income or assets to pay premiums for a death benefit that will be paid to or for the benefit of persons other than the trust's lifetime beneficiaries. A tainted life interest trust will not qualify for a tax-deferred rollover of capital property, and will be subject to the 21-year deemed disposition rule.

PART 4: WHY EQUIVALENT TREATMENT IS GOOD POLICY

Promoting Fairness Through Tax Neutrality

A taxpayer who owns property personally and a taxpayer who owns identical property through a qualifying life interest trust both experience a death-triggered realization event that brings accrued gains into the tax system. Where the same economic gain is taxed at death, the resulting tax burden should not depend on the legal form through which the property was held. Parliament has expressly recognized life interest trusts as an acceptable substitute for testamentary ownership, but the current rules frequently produce materially different outcomes based solely on the ownership vehicle selected. Such distinctions undermine neutrality by imposing different tax consequences on taxpayers in economically equivalent circumstances.

Taxpayers Should Not Be Penalized for Legitimate Estate-Planning Choices

This submission is not a request to reduce the tax otherwise paid on death, but to address family, incapacity, administration, privacy, and succession concerns. The current rules can result in greater tax liability, reduced access to relief provisions, and increased administrative complexity simply because a taxpayer chose a structure better suited to their personal circumstances. Taxpayers should not be required to choose between prudent estate planning and equitable tax treatment. Where Parliament has encouraged the use of life interest trusts for legitimate planning purposes, the tax system should not impose unintended penalties for doing so.

Supporting Seniors and Their Families Through Equitable Tax Policy

The burden imposed by these disparities falls disproportionately on seniors and their families. Alter ego trusts, joint spousal or common law partner trusts, and related life interest trusts are frequently established to facilitate incapacity planning, continuity of asset management, and orderly succession. Taxpayers who adopt these arrangements are often responding to age-related planning concerns rather than seeking tax benefits. It is difficult to justify why these taxpayers should face greater exposure to double taxation, less access to relief provisions, or less flexibility at death than taxpayers who retain direct ownership of property until death.

PART 5: RECOMMENDATIONS

In light of the differential treatment of life interest trusts identified in this submission, STEP Canada respectfully recommend that the Department of Finance consider the following amendments to the life interest trust regime under the Act to help address many of the discrepancies described above for the equal tax treatment of property held personally and property held in a qualifying life interest trust.

Create a "Post Mortem Deemed GRE" Regime for Qualifying Life Interest Trusts

Where a qualifying life interest trust becomes subject to a deemed disposition under subsection 104(4) as a consequence of the death of the relevant life interest beneficiary, the trust should, commencing? in the taxation year deemed to begin under paragraph 104(13.4)(a), be treated as a "post mortem deemed GRE" for specified purposes of the Act.

A post mortem deemed GRE would:

- remain a separate taxpayer;
- continue to be taxed at the top marginal trust tax rate;
- continue to use a calendar taxation year; but
- have access to post mortem relieving provisions, charitable gifting rules, and administrative measures that are currently restricted to GREs, unless there is a specific policy reason to deny such treatment.

Additional Accompanying Legislative Amendments

- **Subsection 40(3.12):** Subsection 40(3.12) should be extended to life interest trusts.
- **Subsection 40(4):** Amend this subsection so that it expressly does not require a designation of principal residence at the time of the initial transfer.
- **Subsection 75(2):** Enact a complementary rule providing that, where foreign-source income is attributed to a person under subsection 75(2), any income or profits tax paid by the trust to a foreign government that can reasonably be regarded as having been paid in respect of that amount shall be deemed to have been paid by that person, and not by the trust.
- **Paragraph 88(1)(d.3):** Add a rule for life interest trusts modelled on paragraph 88(1)(d.3). Where shares of a corporation are deemed to have been disposed of and reacquired by the trust under subsection 104(4), pursuant to paragraph 104(4)(a), (a.1), or (a.4), because of the death of the relevant individual, the trust should be permitted to elect to be deemed, solely for the purposes of paragraphs 88(1)(c), (d), and (d.2), to have last acquired control of the corporation, immediately after the death of the relevant individual, from a person dealing at arm's length with the trust. The rule should similarly apply to each corporation controlled by that corporation. The election should be available even where no actual acquisition of control occurs.

- **Subsection 104(4):** Amend this subsection to exempt alter ego trusts and self-benefit trusts for assets that vest indefeasibly in the spouse within 36 months, and/or if the spouse becomes the lifetime beneficiary of that property.
- **Subsection 111(2):** Extend subsection 111(2), with necessary modifications, to permit a life interest trust to apply eligible net capital losses against income from any source in the taxation year in which the relevant life interest beneficiary dies and in the immediately preceding taxation year.
- **Subsection 126(1):** Amend this subsection so that, for individuals and trusts, and only in respect of deemed disposition capital gain on a death, the foreign tax credit is expanded to include foreign estate tax paid.
- **Subsection 164(6):** Extend subsection 164(6), or enact a parallel rule, to permit a life interest trust to elect to carry back eligible capital losses and terminal-loss deductions realized during the first three taxation years following the death-triggered disposition. The election should permit the elected amounts to be applied against the trust's income for the taxation year that includes the subsection 104(4) deemed disposition; against income reported in the terminal return of the relevant life interest beneficiary; or against both, in the proportions specified in the election.
- **Capital gains deduction:** Where a life interest trust realizes a gain as a consequence of the death-triggered deemed disposition under subsection 104(4), the trust should be entitled to claim a deduction equivalent to the LCGE that would have been available had the qualifying property been owned directly by the deceased life interest beneficiary immediately before death. This relief could be implemented through a legislative mechanism modelled on the former trust LCGE deduction provisions (the former ss. 110.6(12)), with appropriate modifications for alter ego trusts, joint partner trusts, spousal trusts, and other life interest trusts.
- **Life insurance and life interest trust:** To allow a life interest trust to own life insurance without being disqualified, amend the Act to include a provision similar to subsection 70(7) to ensure that a life interest trust may own, and may fund from the capital of the trust, a "life insurance policy in Canada" (as defined in subsection 138(12)), provided that the policy is on the life of the life interest beneficiary (or a related person such as a child or grandchild). This provision would apply to life insurance that is transferred into a life interest trust as well as to a new life insurance policy acquired by the trustee of a life interest trust.