2025 STEP Canada / CRA Roundtable

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Unless otherwise stated, all legislative references hereafter are to the *Income Tax Act,* R.S.C. 1985, c.1 (5th Supp.), as amended (the "Act").

QUESTION 1. Succession of Family Business

Under the new rules for succession of a family business (subsections 84.1(2.31) and 84.1(2.32)), it is clear that there can only be one purchaser corporation.

1. Can the child group own the purchaser corporation through one or more holding companies owned by them?
2. Can shares of the purchaser corporation be held by a trust under which the only beneficiaries are members of the child group?
3. Can shares of the purchaser corporation be held by a trust if the trustees are all members of the child group and the parents are not beneficiaries?

CRA Response

Preliminary Comments – More than one Purchaser Corporation
A taxpayer who disposes of qualified small business corporation shares or shares of the capital stock of a family farm or fishing corporation to a purchaser corporation may qualify for the intergenerational business transfer exception to the application of section 84.1 if, among other things, at the time of the disposition, the purchaser corporation is controlled by one or more children of the taxpayer, each of whom is 18 years of age or older. However, this exception is only available if

[1] We gratefully acknowledge the following CRA personnel who were instrumental in helping us prepare for the Roundtable: Mélanie Beaulieu, Marina Panourgias, Dawn Dannehl, Aleksandra Bogdan, William King, Irina Schnitzer, Stéphane Prud'homme, Daryl Boychuk, Ryan McPherson, Allison Thomas, Urszula Chalupa, François Mathieu, Patrick Bilodeau, Laurence Gagné, Amanda Couvrette, Pamela Burnley, Sarah Springate, Christina Foggia, Yves Moreno, Charles Taylor, Angelina Argento, Vicky Liu, Grace Tu, Gillian Godson, Julia Clarkson, Stéphane Charette, Elizabeth Menard, Christina O'Quinn, Paul Wilson, Hugues Ouimet, Todd Lichty, Jennifer Tong, Crystal Poupart, Mohamed Benchaouche, Chris Deutsch, Justin Lawson, Mady Kabeya, Marie McPhee, Paul Oatway.

the taxpayer has not previously sought, at any time after 2023, to rely on the exception in respect of the same business (Prior Sale Restriction).

The CRA addressed the scope of the Prior Sale Restriction at the CRA Roundtable - 2024 Canadian Tax Foundation Annual Conference (CRA document 2024-1038231C6). In response to a question as to whether simultaneous dispositions of shares of a subject corporation to two purchaser corporations would disqualify either of these dispositions from meeting the requirements of an intergenerational business transfer, the CRA stated that the Prior Sale Restriction did not preclude simultaneous dispositions of shares of the subject corporation to more than one purchaser corporation provided that those dispositions occur as part of the same genuine intergenerational business transfer.

<u>Shares of the Purchaser Corporation held by a Corporation or Trust</u>
It is our understanding that, in each of the three scenarios described above, the question is whether one or more children of the taxpayer will be considered to control the purchaser corporation at the time of the disposition. It should be noted that our views herein are based on the understanding that any reference to a child means a "child" of the taxpayer, as defined in paragraph 84.1(2.3)(a), who is 18 years of age or older.

Part 1.

Paragraphs 84.1(2.31)(b) and 84.2(2.32)(b) require that, at the time the shares of the subject corporation are disposed of by the taxpayer to the purchaser corporation, the purchaser corporation is controlled by one or more children of the taxpayer. While one or more children of the taxpayer are required to control the purchaser corporation, they are not required to own shares directly in the purchaser corporation.

Subsection 256(6.1) states:

> For the purposes of this Act and for greater certainty,
> (a) where a corporation (in this paragraph referred to as the "subsidiary") would be controlled by another corporation (in this paragraph referred to as the "parent") if the parent were not controlled by any person or group of persons, the subsidiary is controlled by
> (i) the parent, and
> (ii) any person or group of persons by whom the parent is controlled; and
> (b) where a corporation (in this paragraph referred to as the "subject corporation") would be controlled by a group of persons (in this paragraph referred to as the "first-tier group") if no corporation that is a member of the first-tier group were controlled by any person or group of persons, the subject corporation is controlled by
> (i) the first-tier group, and
> (ii) any group of one or more persons comprised of, in respect of every member of the first-tier group, either the member, or a person or group of persons by whom the member is controlled.

Paragraph 256(6.1)(a) confirms that a corporation may be controlled directly or through one or more other corporations. Further, paragraph 256(6.1)(b) confirms that a corporation may be controlled by various groups of persons within a corporate structure. Accordingly, the requirement that one or more children of the taxpayer control the purchaser corporation may be met where the controlling interest in the purchaser corporation is held through one or more corporations.

Part 2.

Where shares of a corporation are held by a trust, the trustees of the trust would normally exercise the voting rights attached to those shares. Accordingly, in this scenario, we would generally look to the trustee(s) to determine who controls the purchaser corporation. The fact that the only beneficiaries of the trust are members of the child group is not, in itself, sufficient to meet the requirement that the purchaser corporation be controlled by one or more children of the taxpayer.

For the purposes of subsections 84.1(2.31) and (2.32), paragraphs 84.1(2.3)(c) and (d) contain certain rules that may treat a beneficiary of a trust as owning property held by the trust (such as, in this case, shares of the purchaser corporation). However, these rules are not relevant in determining control of a corporation - they would apply only in determining whether a beneficiary of the trust exceeds the ownership limits applicable to shares or equity interests described in subsections 84.1(2.31) and (2.32).

Part 3.

At the 2022 STEP CRA Roundtable, the CRA addressed the question as to who controls a corporation where the shares of the corporation are held by a trust with multiple trustees. In our response (CRA document 2022-0928191C6), we stated:

> Where a trust has multiple trustees, the determination as to which trustee or group of trustees controls the corporation can only be made after a review of all the pertinent facts, including the terms of the trust document. However, in the absence of evidence to the contrary, we would consider there to be a presumption that all of the trustees would constitute a group that controls the corporation.

In circumstances where a trust holds a controlling interest in the purchaser corporation at the time the taxpayer disposes of shares of the subject corporation to the purchaser corporation, and there are multiple trustees of the trust, we would be guided by the above-noted response in determining who controls the purchaser corporation.

<u>Continuous Control</u>
It should be noted that one or more children of the taxpayer are not only required to control the purchaser corporation at the time the taxpayer disposes of the shares of the subject corporation to the purchaser corporation but also to maintain control of the purchaser corporation, subject to certain exceptions, for 36 months following the disposition (in the case of an immediate intergenerational business transfer) and up to 10 years (in the case of a gradual intergenerational business transfer).

QUESTION 2. <u>Succession of Family Business</u>

It is not permitted for a parent to own any shares in the purchaser corporation or control the purchaser corporation (*de jure* or *de facto* control under the 3-year transition rule or *de jure* control under the 10-year transition rule).

Can shares (which do not amount to control) of the purchaser corporation be held by a trust where:

- the parent is a contingent beneficiary in the event of death of a child or all members of the child group, or
- the parent and the parent's spouse or common-law partner are sole trustees or a majority of the trustees.

CRA Response

The provisions governing intergenerational business transfers do not prohibit a taxpayer (the "parent" referred to in the question) from owning shares of the purchaser corporation or the subject corporation. However, the type and proportion of the shares that the taxpayer may own, directly or indirectly in the purchaser corporation or subject corporation are limited by paragraphs 84.1(2.31)(d) and (e) (immediate intergenerational transfer) and by paragraphs 84.1(2.32)(d), (e) and (f) (gradual intergenerational transfer).

In general, following the disposition of the shares of the subject corporation by a taxpayer to the purchaser corporation, the taxpayer (alone or together with a spouse or common-law partner) cannot own, directly or indirectly, 50% or more of the shares of any class (other than certain non-voting preferred shares) of the purchaser corporation or the subject corporation. Further, within 36 months of the disposition and at all times thereafter, the taxpayer (alone or together with a spouse or common-law partner) cannot own, directly or indirectly, any shares of the purchaser corporation or the subject corporation, other than certain non-voting preferred shares.

The term "own, directly or indirectly" is defined, for the purposes of subsections 84.1(2.31) and (2.32), in paragraph 84.1(2.3)(c):

> (c) "own, directly or indirectly", in respect of a property, means
>
> (i) direct ownership of the property, and
>
> (ii) an ownership interest or, for civil law, a right in the shares of a corporation, an interest in a partnership or an interest in a trust that has a direct or indirect interest or, for civil law, a right, in the property, except that for the purposes of paragraphs (2.31)(d) and (e) and (2.32)(d) and (e), this subparagraph does not apply as a look-through rule for an interest, or for civil law, a right in non-voting preferred shares or debt of
>
> (A) the purchaser corporation (within the meaning of subsections (2.31) and (2.32))
>
> (B) the subject corporation (within the meaning of subsections (2.31) and (2.32)), or
>
> (C) any relevant group entity (within the meaning of subsections (2.31) and (2.32));

Further, with respect to a discretionary interest in a trust, paragraph 84.1(2.3)(d) provides:

> (d) if a person or partnership's share of the accumulating income or capital of a trust in respect of which the person or partnership has an interest as a beneficiary depends on the exercise by a person (in this paragraph referred to as a "trustee") of, or the failure by any trustee to exercise, a discretionary power, that trustee is deemed to have fully exercised the power, or to have failed to exercise the power, as the case may be;

Generally stated, subparagraph 84.1(2.3)(c)(ii) applies to determine a person's indirect ownership interest in a property by "looking-through" intermediary entities while paragraph 84.1(2.3)(d) applies to preclude the use of discretionary interests in a trust to avoid conditions prescribed by subsections 84.1(2.31) and (2.32). For example, paragraph 84.1(2.3)(d) precludes a beneficiary of a trust from taking the position that, due to the discretionary nature of the trust, the beneficiary does not own any property of the trust.

In applying subparagraph 84.1(2.3)(c)(ii), we would not consider a person to have an interest in a trust where that person's interest depends solely on the occurrence of an uncertain event (such as a child predeceasing its parent). Accordingly, we would not, during the life of the child or the lives of the relevant members of the child group (in the circumstances described in the first scenario) treat the parent as owning any shares of the purchaser corporation held by the trust.

With respect to the implications of the parent or the parent's spouse or common-law partner being the sole trustee or a majority of the trustees of a trust that holds a non-controlling interest in the purchaser corporation, we would not consider the parent or the parent's spouse or common-law partner, in their capacity as a trustee, to own shares of the purchaser corporation for the purposes of paragraphs 84.1(2.31)(d) and (e) and paragraphs 84.1(2.32)(d), (e) and (f). In this situation, we would apply the look-through rule in subparagraph 84.1(2.3)(c)(ii) and, if applicable, the deeming rule in paragraph 84.1(2.3)(d), to determine who owns, directly or indirectly, any property held by the trust.

QUESTION 3. <u>Bare Trusts that Ceased to Exist in 2024</u>

A particular bare trust filed a T3RET, *T3 Income Tax and Information Return* ("T3 return"), including Schedule 15, in respect of its 2023 tax year prior to the announcement by the CRA that all bare trusts would not be required to file for the 2023 tax year. The bare trust ceased to exist in 2024. In October 2024, the CRA announced, for the 2024 tax year, a continuation of the exemption from the trust reporting requirements that was issued for bare trusts for the 2023 tax year. As a result, the bare trust will never file a final T3 return. How can the bare trust cancel its trust account number or otherwise advise the CRA that it no longer exists?

CRA Response

To ensure that the trust account number is no longer considered active or open, the trustee may voluntarily choose to either:

- send a letter to the trust's Tax Centre that includes:
    - the trust account number
    - bare trust name
    - the fact that the bare trust has ceased to exist, and
    - the date on which the bare trust ceased to exist; or
- file a final T3 return for the 2024 tax year with the date on which the bare trust ceased to exist.

QUESTION 4. <u>Preferred Beneficiary Election</u>

An individual (the "Individual") is resident in Canada, eligible for the disability tax credit at all relevant times, and is a beneficiary of a Qualified Disability Trust ("QDT"), as defined in subsection 122(3). The Individual is also a beneficiary of another trust (the "Trust"), which does not qualify as a QDT.

Can the CRA confirm whether the preferred beneficiary election in subsection 104(14) would be available to the Individual and the Trust?

CRA Response

Subsection 104(14) generally provides that a trust and a preferred beneficiary under the trust may jointly elect, in prescribed manner, to have a portion of the trust's accumulating income for the trust's taxation year included in computing the income of the preferred beneficiary for the beneficiary's taxation year in which the trust's taxation year ended, provided it does not exceed the allocable amount for the preferred beneficiary for that taxation year.

Pursuant to the definition in subsection 108(1), a preferred beneficiary under a trust for a particular taxation year of the trust means a beneficiary under the trust at the end of the particular year who is resident in Canada at that time if:

(a) the beneficiary is
  (i) an individual in respect of whom paragraphs 118.3(1)(a) to (b) apply for the individual's taxation year that ends in the particular year (the "beneficiary's year"), or
  (ii) an individual
    (A) who attained the age of 18 years before the end of the beneficiary's year, was a dependant (within the meaning assigned by subsection 118(6)) of

another individual for the beneficiary's year and was dependent on the other individual because of mental or physical infirmity, and

(B) whose income (computed without reference to subsection 104(14)) for the beneficiary's year does not exceed the amount determined for F in subsection 118(1.1) for the year, and

(b) the beneficiary is

(i) the settlor of the trust,

(ii) the spouse or common-law partner or former spouse or common-law partner of the settlor of the trust, or

(iii) a child, grandchild or great grandchild of the settlor of the trust or the spouse or common-law partner of any such person.

Since the Individual is eligible for the disability tax credit for the beneficiary's year, they would meet the criteria in subparagraph (a)(i) of the definition of preferred beneficiary in subsection 108(1). If the other relevant conditions in that definition are also satisfied (most notably those in paragraph (b), as outlined above), the Individual would meet the definition of preferred beneficiary in subsection 108(1). In this situation, the preferred beneficiary election under subsection 104(14) would be available to the Trust and the Individual, in respect of a particular year, provided that all of the relevant conditions in that subsection are also satisfied, and the Trust is not a trust described in any of paragraphs (a) to (h) of the definition of trust in subsection 108(1). The fact that the Individual is also a beneficiary of another trust which is a QDT, would not preclude the Trust and the Individual from making a preferred beneficiary election.

QUESTION 5. RDSP Financial Hardship Withdrawals

A registered disability savings plan ("RDSP") is categorized as a primarily Government assisted plan ("PGAP") if government contributions exceed plan holder contributions. Where an RDSP is a PGAP, annual withdrawals are limited to 10% of the value in the RDSP at the beginning of the year. In 2024, the CRA advised that it may permit certain withdrawal requests above the limit in circumstances of financial hardship where it is just and equitable to do so. One of the requirements set out by the CRA was that the plan holder must also be the plan beneficiary.

1. Could the CRA expand on the circumstances in which it would be just and equitable to permit a withdrawal that exceeds the 10% threshold?

2. Would the CRA provide a form to be used to capture the required information for making such a request?

3. Why does the CRA require that the plan holder also be the plan beneficiary, as this requirement would not be met in cases where an adult beneficiary is incapable of managing property or where the beneficiary of the RDSP is a minor and unable to be the plan holder? In both cases there could still be financial hardship.

CRA Response

Part 1.

The CRA considers a waiver request in conformity with the rule of law, the principles of fairness, and due process. We consider each individual circumstance in order to achieve fair treatment and outcomes, especially when rigid application of the law would lead to undue hardship, inequity, or unintended consequences.

These are some of the guidelines that the CRA uses when considering whether it is just and equitable to approve an RDSP waiver request for financial hardship:

- Would the RDSP beneficiary suffer significant harm, loss, or disadvantage from a refused waiver? (Compliance of the law would lead to an unjust or inequitable result).
    - e.g. Could the beneficiary meet the basic necessities of life without access to the trust's funds? Would the beneficiary's health suffer if they do not have access to the trust's funds?
- Would granting the waiver negatively impact the financial viability of the trust? Would there be any impact on family members or caregivers who rely on the trust's integrity for planning and support?
- Would application of the waiver be consistent with legislative intent?
    - e.g. Is the beneficiary using the money for their own benefit or to help someone else? (Perhaps the intention is to help out a relative who is undergoing financial difficulty). The RDSP program is not intended to help anyone other than the beneficiary.

These guidelines are intended to help make sure that the underlying intent of the waived requirement is met while still safeguarding the trust's resources and ensuring the disabled person's long-term financial well-being.

Part 2.

The CRA will create a form for RDSP issuers to fill out when requesting a waiver of the 10% threshold for financial hardship. We anticipate having this posted to our website in 2026.

Part 3.

As the sole purpose of an RDSP is to benefit the RDSP beneficiary, the CRA must make sure that the beneficiary's funds are only being used for the beneficiary's benefit, and not for the benefit of other people. The RDSP trustee also has a fiduciary duty to make sure that the RDSP trust is only being used for the benefit of the beneficiary.

Where the beneficiary and the holder are separate individuals the determination of whether the property of the RDSP is used for the benefit of the beneficiary becomes difficult. Currently, most waiver requests that the CRA has received where the holder and beneficiary are not the same individual are clearly requests to help plan holders who are having financial hardship issues and not for the benefit of the RDSP beneficiaries.

Where an RDSP issuer is of the view that the beneficiary (where the holder and beneficiary are not the same individual) is experiencing financial hardship and the issuer feels that requesting a waiver is in the beneficiary's best interest, they are welcome to send the waiver request to the CRA. The issuer should provide an explanation for why they feel the request warrants an exception to the posted guidelines.

QUESTION 6. Section 116 Partial Distributions from an Estate Covering Multiple Taxation Years

During the administration of an estate or trust, the executor/trustee makes several capital distributions to a non-resident beneficiary spanning multiple years. In some cases, it may be possible to estimate the total value of these distributions in advance, but not the timing of such distributions. The non-resident beneficiary's capital interest in this estate or trust constitutes taxable Canadian property ("TCP") as that term is defined in subsection 248(1). Can the beneficiary file one Form T2062 under subsection 116(1) with the CRA before the above-mentioned distributions based on the estimated value of the total capital distributions that will be distributed to the non-resident beneficiary over multiple years? If the CRA issues a certificate of compliance (Form T2064) pursuant to such request, will the estate/trust be absolved from liability under subsection 116(5) for distributions over the multiple years provided the value of the total capital distributions do not exceed the certificate limit?

CRA Response

Yes, a single Form T2062, *Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property* can be filed in advance of single or multiple capital distributions.

When the CRA has verified the information provided in such notice, and when the CRA has received either an amount to cover the tax on any gain realized by the non-resident beneficiary (the "vendor") upon the disposition of the capital interest in the trust upon the distribution of the property, or appropriate security for such tax, the CRA will issue a certificate of compliance, Form T2064, *Certificate – Proposed Disposition of Property by a Non-Resident of Canada*, under subsection 116(2) establishing a 'certificate limit'.

Any and all capital distributions up to the certificate limit would be covered under a single certificate of compliance. Form T2064 does not indicate a 'disposition date'.

On the actual disposition of the property, if the facts and amounts of the actual disposition differ from those you reported to the CRA for the proposed disposition, another completed form (Form T2062) with the changes and providing the CRA with acceptable security or any additional payment to cover the increase in tax payable should be filed. The CRA will then issue you a certificate of compliance, Form T2068, *Certificate – The Disposition of Property by a Non-Resident of Canada*.

QUESTION 7. <u>Subsection 70(6) and Testamentary Spousal Trust</u>

A taxpayer dies with a will that contains the following provision in connection with the residue of the estate:

> To hold and keep the residue of my estate (the "Residue") invested and to pay the net income derived therefrom to or for the benefit of my spouse, provided that my Trustees may at any time or times pay to or for the benefit of my said spouse such amount or amounts out of the capital of the Residue of my estate as my Trustees in their absolute discretion deem advisable, it being understood that during my spouse's lifetime my spouse is entitled to receive all of the income of the Residue and that no person except my spouse may receive or otherwise obtain the use of any of the income or capital of the Residue, my intention being that the Residue constitute a spousal trust as described in paragraph 70(6)(b) of the Income Tax Act (Canada).

1. Where a formal conveyance of the Residue from the estate of the deceased to a separate trust has not yet occurred, does the CRA consider that the assets forming the Residue have been "transferred to" a spousal trust for the purposes of subsection 70(6)?

2. Does the CRA agree that the above provision results in a separate trust for the purposes of the Act?

3. Does the CRA agree that provided the estate administration has been completed and the assets forming the Residue are determined within 3 years of the taxpayer's death, that the assets of the taxpayer on death that become part of the Residue will be deemed disposed by the taxpayer for proceeds equal to their cost pursuant to subsection 70(6)?

4. What are the consequences if the administration of the estate takes more than 3 years from the time of the taxpayer's death such that the Residue is not known until after 3 years from the taxpayer's death?

CRA Response

Part 1.

When a taxpayer dies, subsection 70(5) provides for a deemed disposition of each capital property of the taxpayer immediately before the death. This could result in taxable capital gains, allowable capital losses, recapture of capital cost allowance, or terminal losses. Where subsection 70(6) is applicable, these tax implications can generally be deferred.

Subsection 70(6) applies where capital property of a deceased taxpayer who was resident in Canada immediately before the taxpayer's death is, as a consequence of the death, transferred or distributed, *inter alia*, to a trust created by the taxpayer's will (referred to herein as a "testamentary spousal trust"), that was resident in Canada immediately after the time the property vested indefeasibly in the trust, and under which:

- the taxpayer's spouse or common-law partner is entitled to receive all of the income of the trust that arises before their death; and
- no person except the spouse or common-law partner may, before their death, receive or otherwise obtain the use of any of the income or capital of the trust.

In addition, the property must, generally, become vested indefeasibly in the trust within 36 months after the death of the taxpayer.

Where subsection 248(8) applies in respect of a testamentary spousal trust, it provides that a property is considered to have been transferred or distributed to the trust as a consequence of a taxpayer's death, when the transfer or distribution was under or as a consequence of the terms of the will or other testamentary instrument of the taxpayer, or as a consequence of the law governing the intestacy of the taxpayer.

In considering the meaning of "transfer or distribute", the Federal Court of Appeal ("FCA") in *The Queen v. Boger Estate* (93 DTC 5276) concluded that a formal conveyance was not necessary to "transfer or distribute" the property in question. The language of subsection 70(6) includes the passing of property under the terms of a valid will.

Accordingly, the absence of a formal conveyance of the Residue to the testamentary spousal trust would not, by itself, preclude the Residue from being transferred or distributed for the purposes of subsection 70(6). However, whether property has been "transferred or distributed" for the purposes of subsection 70(6) is a question of fact and law that will depend on the applicable provincial law, and the particular facts and circumstances of each case, including the terms of the will. In common law provinces and territories, reference to the applicable provincial law includes the common law and relevant provincial or territorial statutes.

In addressing the distinction between trusts and estates, Ian Pryor and Grace Chow in the Practitioner's Guide to Trusts, Estates and Trust Returns, 2024 edition, offer the following guidance in respect of the residue of an estate in common law provinces and territories:

> The personal representative of an estate takes title to the property of the deceased and is obliged to handle that property with many of the same duties of good faith that attach to a trustee, but the division of ownership which is one of the hallmarks of a trust relationship is absent. The beneficiary of a trust holds the equitable title to the property of the trust while the trustee holds the legal title. The beneficiary of an estate however does not, as a rule, enjoy a beneficial interest in the assets while they are under administration and form part of the estate.
>
> The timing of the shift in equitable ownership can be important. Generally, residuary beneficiaries do not enjoy beneficial ownership in the assets comprising the residue until the debts are ascertained and paid, allowing the residue to be known, and not in specific items of

property in the residue until those items are “allocated” or earmarked for the beneficiary. Equitable ownership may pass sooner in the case of a specific bequest or where the whole of the residue is due to a single beneficiary. Where a statute applies to a specific situation and is held to provide for immediate or early vesting then the statute will govern.

Part 2.

For subsection 70(6) to apply to a trust, that trust must be created by a taxpayer’s will. In this regard, subsection 248(9.1) provides that, for the purposes of the Act, a trust shall be considered to be created by a taxpayer’s will if the trust is created under the terms of the taxpayer’s will or by an order of a court in relation to the taxpayer’s estate made under any law of a province that provides for the relief or support of dependants. Accordingly, in order to meet the requirements of subsection 70(6), the testamentary spousal trust would need to be created pursuant to the terms of the taxpayer’s will (or by a court order as described above) and would be separate from the estate.

Whether a valid trust is created is a question of fact and law which is dependent on the applicable provincial law, and the particular facts and circumstances of each case, including the terms of the will.

It is our view that an estate and each trust created by the will of a taxpayer are separate taxable entities for purposes of the Act and each will have their own filing requirements under the Act.

Part 3.

In addition to other specific conditions that must be satisfied for subsection 70(6) to apply to a trust referred to in paragraph 70(6)(b), as outlined in our response to Part 1., the capital property transferred or distributed to the testamentary spousal trust must vest indefeasibly in the trust within 36 months of the death of the taxpayer or, upon written application within that period, within such longer period as the Minister considers reasonable in the circumstances.

The Act does not define the term vested indefeasibly. Accordingly, its meaning must be construed within the context of the provisions where it is used. For the purposes of subsection 70(6), vested indefeasibly refers to the unassailable right to ownership of a particular property that, as a consequence of the death of the owner, has been transferred to a spouse or common-law partner or testamentary spousal trust of the deceased.

In considering the interpretation of the expression indefeasible vesting, the FCA in *Boger* approved the trial judge’s statement of the determinative legal principles that vesting occurs where:

(i) there is no condition precedent to be fulfilled before the gift can take effect; and
(ii) the persons entitled (the children) are ascertained and ready to take possession forthwith, there being no prior interests in existence;

and that a vested interest is indefeasible where there is no condition subsequent or a determinable limitation set out in the grant.

A property can vest indefeasibly in a beneficiary even if the title has not yet been transferred via a legal conveyance or by registration if, for example, there is a specific, non-contingent and uncontested bequest to a spouse or common-law partner after the death of the taxpayer, and if it is clear that there are sufficient assets available in the estate to allow for the distribution of the specific bequest. In respect of the residue of an estate, generally, only once the residue is clarified and the beneficiaries have an enforceable right to the property can the assets thereof vest in the beneficiaries.

Whether the Residue can be considered to vest indefeasibly in the testamentary spousal trust for the purposes of subsection 70(6) is a question of fact and law that can only be determined following a review of the applicable provincial law, facts and circumstances, including the will.

Also note that paragraph 248(9.2)(a) will deem property not to have vested indefeasibly in a testamentary spousal trust, unless the property vested indefeasibly in the trust before the death of the spouse or common-law partner.

Part 4.

As noted in our response to Part 3., in addition to other specific conditions that must be satisfied for subsection 70(6) to apply, the capital property transferred or distributed to the testamentary spousal trust must vest indefeasibly in the trust within 36 months of the death of the taxpayer or, upon written application within that period, within such longer period as the Minister considers reasonable in the circumstances.

If this condition, or any other condition in subsection 70(6) is not met, subsection 70(6) would not be applicable and subsection 70(5) would apply.

In addition, pursuant to the definition of "graduated rate estate" ("GRE") in subsection 248(1), an estate cannot be a GRE for more than 36 months after the death of the taxpayer. Accordingly, to the extent that an estate continues beyond 36 months, it would no longer be a GRE and the estate will be deemed to have a year end immediately before that time pursuant to subsection 249(4.1).

As noted above, if it cannot be shown that the Residue has vested indefeasibly in the testamentary spousal trust within 36 months of the taxpayer's death, a written application can be made to the Minister by the taxpayer's legal representative within that period to request an extension. See Question 14 of the 2023 STEP CRA Roundtable (CRA document 2023-0967371C6) for guidance in respect of an application to extend the 36-month period.

Other income tax consequences may be applicable depending on the facts of a particular situation. Accordingly, the comments provided above are of a very general nature and do not represent an exhaustive list.

QUESTION 8. <u>Subsection 70(6) and Vested Indefeasibly</u>

Spouse A and Spouse B are resident in Canada. Spouse A dies and the terms of Spouse A's will provide that the assets of Spouse A (the "Property") are left to Spouse B provided that Spouse B survives Spouse A by 30 days. Spouse B survives Spouse A by more than 30 days; however, Spouse B dies before the will is probated 8 months after the death of Spouse A. Consequently, there will not be an actual distribution or transfer of legal title of the Property to Spouse B until after the death of Spouse B.

In this circumstance, can subsection 70(6) apply to the deemed disposition of the Property by Spouse A immediately before their death?

CRA Response

Subsection 70(6) applies where capital property of a taxpayer who was resident in Canada immediately before their death is, as a consequence of the death, transferred or distributed, *inter alia*, to the taxpayer's spouse or common-law partner who was resident in Canada immediately before the taxpayer's death. In addition, the property must, generally, become vested indefeasibly in the spouse or common-law partner within 36 months after the death of the taxpayer.

By virtue of paragraph 248(9.2)(b), property will be deemed not to have vested indefeasibly in an individual (other than a trust), unless the property vested indefeasibly in the individual before the death of the individual.

Therefore, in order for subsection 70(6) to apply in this case, the Property must be transferred or distributed to Spouse B, as a consequence of the death of Spouse A, and the Property must vest indefeasibly in Spouse B before their death.

The Act does not define the term vested indefeasibly. Accordingly, its meaning must be construed within the context of the provisions where it is used. For the purposes of subsection 70(6), vested indefeasibly refers to the unassailable right to ownership of a particular property that, as a consequence of the death of the owner, has been transferred to a spouse or common-law partner of the deceased.

A property can vest indefeasibly in a beneficiary even if the title has not yet been transferred via a legal conveyance or by registration if, for example, there is a specific, non-contingent and uncontested bequest to a spouse or common-law partner after the death of the taxpayer, and if it is clear that there are sufficient assets available in the estate to allow for the distribution of the specific bequest. If a bequest is not specific, a property will only vest when it has been specifically identified and a beneficiary has an enforceable right to the property.

Whether the Property vested indefeasibly in Spouse B before the death of Spouse B, and whether the Property was transferred or distributed to Spouse B for the purposes of subsection 70(6), are questions of fact and law that can only be determined based on an analysis of all the relevant facts and circumstances, and the applicable law. However, the fact that Spouse B died before there was an actual distribution or transfer of legal title of the Property, but after the 30-day requirement in the will, would not, by itself, prevent the conditions of subsection 70(6) from being met.

QUESTION 9. Flipped Property and Section 85

A deceased individual (the “Deceased”) held 100% of the shares of a corporation (“RE Co”) which owns a long-term Canadian residential property as capital property. The estate undertakes a post-mortem pipeline and bump transaction whereby all the shares of RE Co are sold by the estate to a corporation (“Newco”) for a promissory note, and after some time RE Co is amalgamated with Newco to form Amalco.

At the 2024 CTF and APFF Roundtables, the CRA stated that an amalgamation restarts the holding period for purpose of the “flipped property” definition.

1. Can the CRA confirm that, in the above-described fact pattern, the flipped property rules deem any recapture income and gain to be treated as business income if Amalco sells the residential property within 365 days of the amalgamation?

2. If, within 365 days of the amalgamation, Amalco sells the residential property to another corporation for share consideration and files a subsection 85(1) election, would the flipped property rules cause the election to be invalid because real property inventory cannot be “eligible property” pursuant to subsection 85(1.1)?

CRA Response

The flipped property rules contained in subsections 12(12) to 12(14) (the “Flipped Property Rules”) deem certain property, in which a gain would be realized, as inventory, the disposition of which results in business income. In particular, subsection 12(12) provides that, if absent this provision, and the principal residence exemption in paragraph 40(2)(b), a taxpayer would have had a gain from the disposition of a flipped property, then throughout the period that the taxpayer owned the flipped property, the taxpayer is deemed to carry on a business that is an adventure or concern in the nature of trade with respect to the flipped property. Additionally, the flipped property is deemed to be inventory of the taxpayer's business and not to be capital property of the taxpayer.

In general terms, subsection 12(13) defines the term "flipped property" for purposes of subsections 12(12) and 12(14) to mean a property, other than inventory, that is, prior to its disposition by the taxpayer, a housing unit located in Canada or a right to acquire a housing unit located in Canada. Furthermore, the housing unit must be owned or, in the case of a right to acquire, held, by the taxpayer for less than 365 consecutive days prior to its disposition, other than a disposition that can reasonably be considered to occur due to, or in anticipation of, one or more of the events listed in subparagraphs 12(13)(b)(i) to 12(13)(b)(ix).

Paragraph 87(2)(a) provides that a corporate entity formed as a result of an amalgamation shall be deemed to be a new corporation. The new corporation is not, for the purposes of the Flipped Property Rules, considered to be the same corporation as, and a continuation of, any of its predecessor corporations. As a result, the holding period for an amalgamated corporation, such as Amalco, begins at the time of the amalgamation. Thus, in the situation described, if Amalco owns the property for less than 365 consecutive days prior to its disposition, the Flipped Property Rules could apply provided all other conditions for the application of these rules are otherwise met.

In circumstances where subsection 12(12) applies, Amalco will be deemed to carry on a business that is an adventure or concern in the nature of trade with respect to the flipped property. As well, the flipped property will be deemed to be inventory and not capital property of Amalco's business throughout the period that Amalco owned the property. Any recapture and gains that would have otherwise been realized on the disposal of the property, if subsection 12(12) did not apply, will therefore be considered business income (i.e., profit from the disposition of inventory).

In the situation where Amalco transfers the property to another corporation in exchange for consideration that includes shares, and files an election under subsection 85(1), it is our view that the Flipped Property Rules would not apply if, as a result of the election, the property is disposed of for an agreed amount that does not exceed its capital cost. In other words, the Flipped Property Rules will not apply in this situation, provided that the disposition of the property would not, in the absence of the Flipped Property Rules, give rise to a capital gain. However, if the property is disposed of for an agreed amount that is greater than the property's capital cost (that is, the elected amount agreed upon by Amalco and the other corporation provides for a portion of the accrued capital gain on the property to be realized upon the disposition), then the deeming rule in subsection 12(12) would apply with all of the consequences that flow from its application. This includes causing Amalco's subsection 85(1) election to be invalid because inventory that is real or immovable property is not "eligible property" pursuant to the definition of that term in subsection 85(1.1).

Please note that the CRA could, depending on the circumstances, consider applying the General Anti-Avoidance Rule under subsection 245(2) if one of the main purposes of a transaction is to obtain a tax benefit, to which the taxpayer would not otherwise have been entitled to.

QUESTION 10. Principal Residence Exemption and Subsection 73(1) Transfer to a Life Interest Trust

An individual, over age 65, transfers a "city" and a "recreational" property that could both otherwise qualify as their principal residence to a life interest trust ("LIT").[2] The properties have been owned for

[2] A life interest trust generally includes an alter ego trust, a joint spousal or common-law partner trust, and a spousal trust, which are trusts that are generally described in paragraph 73(1.01)(c). Furthermore, subject to the requirements of subsection 73(1.02), a qualifying transfer for purposes of subsection 73(1) includes property transferred by an individual in circumstances to which subsection (1.01) applies where it is transferred, among others, to one of the trusts described in paragraph 73(1.01)(c).

many years and there is the desire to maintain flexibility as to which property will be designated as the principal residence upon an ultimate sale by the LIT. By virtue of subparagraph 40(4)(b)(ii) and assuming subsection 73(1.01) applies, the property will be the principal residence of the LIT for any year that it was the principal residence of the transferor taxpayer. This differs from the language in subparagraph 40(4)(b)(i) which, in the case of a transfer to a testamentary spouse trust, refers to if the property had been designated as the principal residence of the transferor.

Does this mean that the individual must choose which of the city or recreational property they will designate as their principal residence for the years prior to the transfer at the time of transfer, as opposed to when the life interest beneficiary dies, or at the time of the ultimate sale by the LIT?

CRA Response

The CRA's general views on claiming the principal residence exemption ("PRE") are set out in Income Tax Folio S1-F3-C2 "Principal Residence" ("Folio"). Generally, if a property qualifies as a taxpayer's principal residence as defined in section 54, an exemption can be claimed under paragraph 40(2)(b) to reduce or eliminate any capital gain otherwise occurring for income tax purposes on the disposition (or deemed disposition) of the property. The definition of "principal residence" provides the conditions which must be met for a property that is a housing unit to qualify as a taxpayer's principal residence, including, in paragraph (c), that the taxpayer designates the property as their "principal residence" for the year. Additionally, no other property can be designated by the taxpayer for the year and, where the designation is for a year after 1981, no other property can be designated as the principal residence of any member of the taxpayer's family unit for the year, as described in paragraph 2.13 of the Folio.

In general, subsection 40(4) is applicable on the disposition of a property by an individual, that was previously acquired from a taxpayer ("Transferor") pursuant to the rollover provisions of subsection 70(6) or 73(1). In particular, this subsection deems certain conditions to have been met for the purpose of determining the individual's ("Transferee") gain under paragraph 40(2)(b) on a subsequent disposition of the property. More specifically, pursuant to paragraph 40(4)(a), the Transferee is deemed to have owned the property throughout the period during which the Transferor owned it. Paragraph 40(4)(b) provides that:

(i) in the case of property transferred under subsection 70(6), the property shall be deemed to have been the Transferee's principal residence for any taxation year <u>for which it would, if the Transferor had designated it in prescribed manner</u> to have been the Transferor's principal residence for that year, have been the Transferor's principal residence; and
(ii) in the case of property transferred under subsection 73(1), the property shall be deemed to have been the Transferee's principal residence for any taxation year <u>for which it was</u> the Transferor's principal residence.

In general terms, the effect of subsection 40(4) is to make it possible for the Transferee to claim the PRE under paragraph 40(2)(b) for taxation years when the property would have been, or was, as the case may be, the Transferor's principal residence.

The difference between the application of subsection 40(4) to property acquired pursuant to subsection 73(1) (an *inter vivos* transfer of capital property) and to property acquired pursuant to subsection 70(6) (a transfer of capital property on death) is that property transferred in the latter situation (that is, on death) is deemed to be the principal residence of the Transferee for each year in which it was eligible to be the deceased Transferor's principal residence rather than just for each year in which it actually was the Transferor's principal residence. The stricter language in subparagraph 40(4)(b)(ii) that pertains to a subsection 73(1) transfer imposes a requirement for the designation condition in the principal residence definition to be satisfied by the Transferor.

The principal residence designation condition for individuals, mentioned earlier, requires that the designation must be made by the taxpayer in a prescribed form and manner. The prescribed form for an individual (other than a trust) to make their principal residence designation is the T2091IND, *Designation of a Property as a Principal Residence by an Individual (Other Than a Personal Trust)* ("T2091 Form"). The prescribed manner of designation is described in section 2301 of the *Income Tax Regulations* ("Regulations"), which provides that any designation by a taxpayer under the principal residence definition shall be made in the return of income required by section 150 to be filed by him for any taxation year of the taxpayer in which (a) he has disposed of property that is to be designated as his principal residence; or (b) he has granted an option to acquire such property.

In general terms, according to paragraph (c) of the definition of the term "disposition" in subsection 248(1), a disposition of any property is defined to include "any transfer of the property to a trust, except as provided by paragraph (f) or (k)" of that definition. In our view, generally, neither of the exceptions in paragraphs (f) or (k) would apply to the situation you have described. Furthermore, it is our view that the exclusion in paragraph (e) of the definition of "disposition" would not apply to the situation. Accordingly, a transfer of a property by a taxpayer pursuant to subsection 73(1) will generally constitute a "disposition" within the meaning of the term in subsection 248(1), and will therefore require a taxpayer to file a principal residence designation form (that is, a T2091 Form) in their tax return for the year in which the disposition occurs in order to satisfy the principal residence requirements.

In summary, even though the transfer of the properties takes place on a tax deferred basis pursuant to subsection 73(1), a disposition is generally considered to occur on a transfer of a property to a trust, including a life interest trust. Therefore, in accordance with the legislation (section 2301 of the Regulations), the Transferor must file a T2091 Form and make the decision of which of their two properties to designate as their principal residence for the years preceding the transfer with their return of income for the year in which the disposition of the property occurs. It follows that, in accordance with subparagraph 40(4)(b)(ii), when the life interest trust disposes of the property, it will be deemed to have been the life interest trust's principal residence for the taxation years for which it was the Transferor's principal residence.

QUESTION 11. Acquisition of Control of a Corporation

An *inter vivos* discretionary trust with three trustees ("Trustees") holds the controlling shares of a Canadian corporation ("Corporation"). These shares are distributed ("Distribution") to a beneficiary who is an individual ("Individual"). In order to prevent a loss restriction event to occur for the corporation, does clause 256(7)(a)(i)(A) require that the individual be related to each of the Trustees?

CRA Response

Where the majority of the voting shares of a corporation is held by a trust, it is the trustees of the trust who have legal ownership of the shares, who have the right to vote those shares and who, therefore, control the corporation.[3] Where a trust has multiple trustees, the determination as to which trustee or group of trustees controls the corporation can only be made after a review of all the pertinent facts, including the terms of the indenture. However, in the absence of evidence to the contrary, the CRA considers there to be a presumption that all of the trustees would constitute a group that controls the corporation.

Subject to the provisions of paragraph 256(7)(a), a loss restriction event would occur as a result of the Distribution. However, control of the Corporation shall be deemed not to have been acquired pursuant to clause 256(7)(a)(i)(A) if the Individual was related to each of the Trustees immediately before the Distribution.

[3] *M.N.R.* v. *Consolidated Holding Company Limited*, 72 DTC 6007 (SCC).

QUESTION 12. <u>CRA Update on Subsection 55(2) and Safe Income – Where Are We Now?</u>

According to the CRA paper "*CRA Update on Subsection 55(2) and Safe Income – Where Are We Now?*"[4] (the "Safe Income Paper") presented at the 2023 CTF CRA Roundtable, when a corporation transfers assets as part of a reorganization (a "spin-out") covered by paragraph 55(3)(a), safe income of the transferor corporation should be allocated to the transferee corporation pursuant to a proration based on the net cost amount of underlying assets transferred.

In Example 17 of the Safe Income Paper, the CRA provided an example where the entire direct safe income ("DSI") of a transferor corporation ("Opco") was to be allocated to a transferee corporation ("Newco") as a result of a spin-out. Specifically, Opco, a subsidiary wholly-owned corporation of Holdco, had DSI of $1,000 and two assets (Asset 1 with an adjusted cost base ("ACB") of nil and a fair market value ("FMV") of $1,000, and Asset 2 with an ACB of $1,000 and a FMV of $1,000). The DSI of Opco was reflected in the ACB of Asset 2.

Opco undertook a spin-out covered by paragraph 55(3)(a) to transfer Asset 2 to Newco, a corporation wholly-owned by Holdco. As part of the spin-out, Holdco transferred shares of Opco with an ACB of nil and a FMV of $1,000 to Newco in consideration for shares of Newco with an ACB and paid-up capital ("PUC") of nil and a FMV of $1,000. Opco then transferred Asset 2 to Newco in consideration for shares of Newco with an ACB, PUC and FMV of $1,000. The shares held by Newco in Opco and by Opco in Newco were redeemed for notes and the notes were cross-cancelled. We understand that, as a result of the redemption of the shares of Opco held by Newco, Newco was deemed to have received a taxable dividend of $1,000 (the "Deemed Dividend"). Finally, the CRA concluded that the entire $1,000 DSI of Opco was transferred to the shares of Newco held by Holdco.

Under the same facts as described in Example 17, if this spin-out is not within the ambit of paragraph 55(3)(a) because the shares of Opco are subsequently sold to an unrelated person as part of a series of transactions that includes the Deemed Dividend, can the CRA confirm that the entire $1,000 DSI of Opco still shifts to the shares of Newco held by Holdco?

Furthermore, does the CRA agree that the Deemed Dividend would be fully sheltered by the $1,000 DSI of Opco such that subsection 55(2) would not apply (even if the shares of Opco so redeemed only accounted for 50% of the FMV of all of the issued shares of Opco)?

CRA Response

For the same reasons as those stated in Example 17 of the Safe Income Paper, it is the CRA's view that the entire $1,000 DSI of Opco would shift to the shares of Newco held by Holdco as a result of the spin-out of Asset 2 to Newco even if the spin-out ultimately failed to meet the conditions for the exemption provided by paragraph 55(3)(a).

Immediately after the spin-out of Asset 2 to Newco, Holdco holds the shares in Opco with an ACB of $0 and a FMV of $1,000 and Opco owns Asset 1 with an ACB of $0 and a FMV of $1,000. Holdco also holds the shares of Newco with an ACB of $0 and a FMV of $1,000 and Newco owns Asset 2 with an ACB and FMV of $1,000. Since the $1,000 DSI of Opco is reflected in the ACB of Asset 2, it is reasonable to conclude that, after the spin-out, the $1,000 DSI of Opco contributes to the gain on the shares of Newco held by Holdco and does not contribute to any gain on the shares of Opco retained by Holdco. It would therefore not be appropriate to conclude that the $1,000 DSI of Opco or a portion thereof remains with the shares of Opco held by Holdco following the spin-out. The same result and conclusions would apply if a subsequent sale of the shares of Opco occurs within the series of transactions (as here) or if the shares of Opco remain within the related corporate group (as in Example 17 of the Safe Income Paper).

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[4] Ton-That, M. "CRA Update on Subsection 55(2) and Safe Income: Where Are We Now?", 75th Annual Tax Conference, 2023.

Based on the foregoing, it would also follow that, immediately prior to the redemption of the shares of Opco held by Newco, the $1,000 DSI of Opco would reasonably be viewed as contributing to the accrued gain on the shares so redeemed such that subsection 55(2) should not apply to the Deemed Dividend.

QUESTION 13. Trust Holdbacks and Section 159 Clearance Certificate Requests

Where trustees of a trust distribute the assets of the trust, but hold back $1,000,000 of cash or other assets representing all or a portion of the assets distributed until a clearance certificate under subsection 159(2) has been obtained by the trustees, can the CRA confirm that the property subject to the holdback is to be reported as a bare trust arrangement separate and apart from the trust? Would the response change if the amounts held back were subject to a signed holdback agreement where the beneficiaries agreed that the amount of the holdbacks would be used to pay any ongoing costs and any additional taxes identified through the clearance certificate process?

CRA Response

The question asks for clarification of the T3RET, *T3 Income Tax and Information Return* (T3 return) filing requirements where the trustee continues to hold property, and whether the holding of the property does or does not constitute a bare trust arrangement.[5]

Section 159 outlines the need for a legal representative to obtain a clearance certificate.[6] For the purposes of subsection 159(2), a legal representative includes a trustee (other than a trustee in bankruptcy) or an executor administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with a trust or estate's property. Subsection 159(2) requires the

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[5] As outlined in question 3.1 of the Enhanced Reporting Rules for Trusts and Bare Trusts (see footnote 8 for the URL), the term "bare trust" is not defined in the Act. However, subsection 104(1) provides that a bare trust for income tax purposes is a trust arrangement under which the trustee can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property.

A trustee can reasonably be considered to act as agent for a beneficiary when the trustee has no significant powers or responsibilities, the trustee can take no action without instructions from that beneficiary and the trustee's only function is to hold legal title to the property. In order for the trustee to be considered to be the agent for all the beneficiaries of a trust, it would generally be necessary for the trust to consult and take instructions from each and every beneficiary with respect to all dealings with all of the trust property.

[6] Process and filing requirements while obtaining a clearance certificate:

You may request a clearance certificate using Form TX19, Asking for a Clearance Certificate after all of the necessary returns have been filed; you have received the notices of assessment for the returns; any outstanding balances owing to the CRA have been paid or secured and there are no outstanding requests for adjustments, taxpayer relief, objections or appeals.

As outlined in paragraph 11 of Information Circular IC82-R13, *Clearance Certificates,* the CRA will issue a clearance certificate, where you have completed all of the following:

a) you establish a scheme of distribution by a date chosen by you, which is prior to the date of your request for a clearance certificate;
b) you calculate the tax payable as if the distribution had occurred on the chosen date;
c) you file a final tax return for the tax year ending on the chosen date and pay any taxes, interest, and penalties that are chargeable against or payable out of the estate or trust property; and
d) you submit the request in writing (via Form TX19 and supporting documents) including a statement that you will complete the distribution of all the property as soon as possible after receipt of the clearance certificate.

legal representative of a trust to obtain a clearance certificate which certifies that all amounts for which the trust is, or can reasonably be expected to become, liable under the Act at or before the time of distribution have been paid, or that the Minister of National Revenue has accepted security for payment. The certificate applies to amounts for which you are or may become liable for payment as the legal representative. Subsection 159(3) would hold the legal representative personally liable for those unpaid amounts which are owing by the trust to the extent of the value of the property distributed before a clearance certificate has been obtained under subsection 159(2).

See Information Circular IC82-6R13, *Clearance Certificate*,[7] for additional guidance, including information on when a distribution is considered to have been made.

As outlined in questions 1.1 and 1.2 of the Enhanced Reporting Rules for Trusts and Bare Trusts,[8] determining whether a particular arrangement is a trust is a question of fact and law based on an analysis of the circumstances specific to each situation under the applicable private law. As such, it is the responsibility of the parties involved in an arrangement to determine the true nature of their legal relationships and whether they give rise to a trust and if so, whether it is a bare trust.

Where a bare trust, that is an express trust, is created, unless any of paragraphs 150(1.2)(a) to (p) is applicable, the bare trust would be required to file a T3 return, pursuant to section 150 and to provide the beneficial ownership information outlined on Schedule 15 when required under subsection 204.2(1) of the Regulations.

In the situation where the legal representative (trustee of a trust) has distributed all of the assets of the trust but holds back $1,000,000 of assets pending receipt of a clearance certificate under subsection 159(2), it is a question of fact and law as to whether a bare trust exists.

Further, where the taxpayer has determined that a bare trust has been created, unless exempted by another provision, there would be a filing obligation for a T3 return and a requirement to provide the beneficial ownership information. For the 2023 and 2024 taxation years, the CRA does not require bare trusts to file a T3 return, including Schedule 15, unless the CRA makes a direct request for these filings.

QUESTION 14. Late Section 116 Submission

A Canadian resident individual dies, leaving in his estate a Canadian real estate property (“Property”) with a fair market value (“FMV”) of $1,000,000 and cash and marketable securities with a total FMV of $500,000.

The beneficiaries of the estate are three adult children of the individual, one of whom is resident in a country with which Canada has a tax treaty (the other two are residents of Canada). One of the Canadian resident beneficiaries is the executor of the estate, and the deceased individual’s will provides that the beneficiaries share equally in the residue of the estate. In the first tax year of the estate, the Property is sold[9] and $750,000 is distributed to the beneficiaries ($250,000 each).

As a result of that distribution, the non-resident beneficiary is considered to have disposed of a portion of their capital interest in the estate which itself is taxable Canadian property (“TCP”) according to the meaning of that term in subsection 248(1) (immediately after the death, the FMV of the Property represents more than 50% of the value of the estate’s assets). In such a situation, the

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[7] https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic82-6.html
[8] https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/enhanced-reporting-rules-trusts-bare-trusts-faq.html

[9] The Property is sold for proceeds of disposition of $1,000,000.

estate will be considered, for the purposes of subsection 116(5), a purchaser having acquired a TCP from the non-resident beneficiary.

The non-resident beneficiary does not file a notice using Form T2062 in respect of the disposition of a portion of their capital interest in the estate as required under subsection 116(3) and the estate does not file a notice provided for in subsection 116(5.02). The failure to file notices is subsequently identified.

If the non-resident beneficiary were to late file the notice required under subsection 116(3) and pay the applicable late filing penalty under subsection 162(7), can the CRA advise whether the estate would be liable for the tax under subsection 116(5) and/or the penalty under subsection 227(9)?

CRA Response

As pointed out in paragraphs 50 to 58 of Information Circular IC 72-17R6, *Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada - Section 116* and CRA documents 2008-0275871C6 (2008 STEP CRA Roundtable, Question #7) and 2007-0244291E5, a non-resident receiving a distribution in satisfaction of an interest in a trust that is TCP is required to file notice under section 116.

CRA document 2006-0184741E5 points out that a reference to the purchaser in section 116 in respect of the disposition of a capital interest in a trust or estate is to be viewed as a reference to the trust or estate:

> For the purpose of applying section 116 of the Act, our view is that the trust or the estate making the distribution of capital to the non-resident beneficiary is considered to be the purchaser for the purposes of subsection 116(5) of the Act with the result that the trust or the estate would be liable under subsection 116(5) to pay the amount described in that subsection on behalf of the non-resident beneficiary. (See paragraphs 43 to 50 of Information Circular IC 72-17R5.)

Paragraph 52 of Information Circular IC 72-17R6 indicates that no notice is required where the trust or estate interest is treaty-exempt property, except where the trust or estate is related to the beneficiary:

> 52. Since the purchaser's liability under subsection 116(5) does not apply to the disposition of excluded property, there is no purchaser's liability in respect of such property. An excluded property includes a treaty-exempt property. To qualify as a treaty-exempt property, the property must be a treaty-protected property and if the vendor and purchaser are related, Form T2062C must be submitted by the purchaser. If Form T2062C is not submitted by a purchaser who is related to the vendor, a treaty-protected property will not be considered an excluded property and the regular purchaser's liability and vendor notification requirements will apply.
>
> In addition, the purchaser's liability does not apply if all of the following conditions are met: (a) after reasonable inquiry, the purchaser has determined the vendor's country of residence; (b) the property is treaty-protected under the tax treaty that Canada has with the vendor's declared country of residence; and (c) where the vendor and purchaser are related, a T2062C is submitted by the purchaser within 30 days after the date of acquisition.

The question does not indicate whether the trust interest is treaty-protected property. Even if it is, since the estate and the beneficiary described in the question are related, in order for the trust interest to qualify as a treaty-exempt property, the estate must file a notice (Form T2062C) under subsection 116(5.02) within 30 days after the date of the acquisition of the trust interest which was not done.

Under section 116, non-resident vendors ("Vendor") who dispose of certain TCP have to notify the CRA of the disposition either under subsection 116(1) before they dispose of the property or within ten days after the disposition under subsection 116(3). There are no late notifications allowed under subsection 116(5.02). If the purchaser does not file the notice within the stipulated 30 days, then the Vendor is required to file notice under subsection 116(3) because the excluded property exemption is not available.

Administratively, the CRA will process a late filed notification under subsection 116(3) as long as it is complete and received on or before the due-date of the Vendor's Part I income tax return for the taxation year during which the disposition occurred. A complete notification includes the required information as stipulated in subsection 116(3), supporting documentation and any applicable payment (or security). When the CRA has verified the information provided in the notice, the CRA will issue a certificate of compliance to the Vendor (and a copy to the purchaser).

The issuance of the certificate of compliance will relieve the purchaser of their obligation even though the notification was late.

In all cases, submission of a notification (whether under subsections 116(5.02), 116(1) or 116(3)) should be considered as early as possible in the disposition process to avoid the risk associated with subsection 116(5).

If the CRA has not issued a certificate of compliance under section 116, the estate as purchaser is liable to pay and remit the amount specified in subsection 116(5), as tax on behalf of the Vendor, and the penalty pursuant to subsection 227(9) would apply if the conditions are met, plus any applicable interest for failure to pay and remit. The purchaser is entitled to withhold that amount from the purchase price. If the purchaser does not remit the amount required under subsection 116(5) to the CRA, a purchaser liability assessment for that amount may be raised against the purchaser under subsection 227(10.1). Purchaser liability assessments are not subject to any time restrictions. Therefore, an assessment may be issued at any time the CRA becomes aware that a Vendor or purchaser has not adhered to the requirements of section 116.

In summary, the non-resident vendor (i.e., the non-resident beneficiary) filing a late notification under subsection 116(3) and paying the applicable late filing penalty under subsection 227(9) would only relieve the estate's obligation to pay and remit the amount determined under subsection 116(5) if the late notification results in the issuance of a certificate of compliance under subsection 116(4).

For penalties and interest, the Minister has the discretion under subsection 220(3.1) to waive or cancel all or any portion of any penalty or interest if it is found that the penalty or interest resulted from circumstances beyond the control of the purchaser. For more information, refer to the current version of Information Circular IC07-1, *Taxpayer Relief Provisions*.

QUESTION 15. Section 116 Compliance

Where a trust or estate (hereinafter referred to as a trust) resident in Canada derives its value primarily from Canadian real estate (or other taxable Canadian property ("TCP") as that term is defined in subsection 248(1)), a beneficiary's capital interest in the trust is TCP.

If Canadian real estate that forms part of the capital of a personal trust is distributed to a non-resident beneficiary of the trust, a rollover applies pursuant to subsection 107(2). We understand that as part of the certificate of compliance process under section 116, a valuation of the property is required. Can CRA explain why a valuation is required where a rollover results?

CRA Response

Provided all of the conditions for the application of subsection 107(2) have been met, the distribution of the real estate to the non-resident beneficiary will generally occur on a tax deferred basis. Since the property distributed to the non-resident beneficiary is described in subparagraph 128.1(4)(b)(i), subsection 107(5) does not apply to prohibit the rollover provided by subsection 107(2). Paragraph 107(2)(c) determines the proceeds of disposition of a beneficiary's capital interest in the trust. Depending on the facts of a particular situation, where 107(2) is applicable, the non-resident beneficiary's proceeds of disposition is generally equal to the adjusted cost base ("ACB") of the property to the trust before the distribution.[10]

Where the proceeds of disposition of the capital interest in the trust, as determined by paragraph 107(2)(c), is less than its fair market value ("FMV"), the condition in subsection 116(5.1) is met. As a result, subsection 116(5.1) deems the consideration paid by the trust to be the FMV of the Canadian real estate received for the purpose of section 116.

On an administrative basis, despite subsection 116(5.1), in these circumstances the CRA will accept the rollover amount under section 107(2) as proceeds for the purpose of the issuance of a certificate of compliance under section 116, for cases where there is clearly no risk to the Canadian tax base. That would include situations where the transferred property is property described in subparagraphs 128.1(4)(b)(i) to (iii) which includes Canadian real estate. In other words, in the circumstances described, the CRA will issue a certificate of compliance under section 116 reflecting that the proceeds of disposition of the capital interest in the trust is equal to the ACB of the distributed property to the trust. The FMV of the distributed property provided to the CRA during the notification process will be listed in the notes on the certificate of compliance. This recognizes that the deferral of the capital gain in respect of the non-resident's capital interest in the trust (which is TCP) will ultimately be realized and included in income under Part I when the non-resident beneficiary disposes of the Canadian real estate.

The documentation supporting the information required under subsections 116(1), (3) and (5.02) will depend on the nature of the disposition and the type of trust but could include the following:

- Trust agreement or will to identify the beneficiaries and of the nature of their entitlement to capital.
- Provincial probate documents to identify the assets and liabilities of the estate of a deceased (probate documents will not include assets which are not considered part of the estate).
- Final T1 return of deceased.
- Trust (T3) tax returns that have been filed.
- Financial statements and Statement of Assets and Liabilities if prepared by the trust, as these do not have to be submitted with the trust tax return.
- Reasonable support for the valuation of the property distributed.

[10] Certain adjustments in paragraphs 107(2)(b) and (c) may impact the deemed proceeds of disposition of the beneficiary's capital interest; however, we have assumed that none of the adjustments would apply in the current situation.