JANUARY 2020 ■ VOLUME 19 NO. 1

STEP Inside

NEWSLETTER OF THE SOCIETY OF TRUST AND ESTATE PRACTITIONERS (CANADA)

STEP Inside

STEP Inside is published three times a year by the Society of Trust and Estate Practitioners (Canada), an organization of individuals from the legal, accounting, corporate trust and related professions who are involved, at a specialist level, with the planning, creation, management of and accounting for trusts and estates, executorship administration and related taxes. STEP Canada has branches in the Atlantic region, Montreal, Ottawa, Toronto, Winnipeg, Edmonton, Calgary, and Vancouver; and three chapters in London and Southwestern Ontario, the Okanagan Valley, and Saskatchewan.

All enquiries, comments and correspondence may be directed to:

STEP Canada
45 Sheppard Avenue East, Suite 510
Toronto, ON, M2N 5W9
www.step.ca

Tel 416-491-4949 • Fax 416-491-9499
E-mail news@step.ca

ISSN: 14960737

FROM THE EDITORIAL COMMITTEE

We live in a global economy in which goods and services move across international borders. Similarly, families often have members who live in different countries, commonly because children go abroad to study, subsequently work, and ultimately reside outside Canada. This trend is affecting estate planning.

Estate plans must anticipate the situation in which a beneficiary of a family trust is not a resident of Canada when he or she receives a distribution 21 years after the trust is settled. In fact, all beneficiaries of a trust may be non-residents of Canada when the trust's 21-year anniversary occurs. Practitioners must ask themselves several questions in this regard. Are the terms of the trust deed sufficiently flexible to accommodate planning involving non-resident beneficiaries? Is it necessary to vary the terms of the trust so that these beneficiaries may be accommodated? What happens if the beneficiary is a resident of the United States?

Planning must also be flexible enough to adapt to unexpected income tax implications that result either from legislative changes or from a change in the Canada Revenue Agency's (CRA's) administrative position. Consider, for example, the recent changes to section 212.1.

In this issue, we focus on non-resident beneficiaries and discuss several tax tips and traps that must be taken into account when planning for these beneficiaries. Elie Roth, TEP, and Ray Rubin discuss strategies when dealing with 21-year planning involving non-resident beneficiaries, including varying a trust to include a corporate beneficiary and assigning a beneficial interest to a Canadian corporation. The authors caution that these strategies must be assessed against the CRA's potential application of the general anti-avoidance rule. Henry Shew, TEP, explains the double taxation that arises as a result of the new lookthrough rule for trusts under section 212.1. Catherine Eberl highlights the additional US tax compliance issues that arise when a non-resident beneficiary is a US person receiving a distribution from a grantor trust or a non-grantor trust.

21-Year-Rule Planning for Trusts with Non-Resident Beneficiaries

ELIE S. ROTH, TEP
Davies Ward Phillips & Vineberg LLP
Member, STEP Toronto

R. RAY RUBIN
Davies Ward Phillips & Vineberg LLP

Trustees of trusts that are resident in Canada or hold taxable Canadian property may be confronted with the 21-year rule in subsection 104(4) of the *Income Tax Act*, which deems a trust to have disposed of its capital property and certain other property on the day that is 21 years after its creation and every 21 years thereafter, and to have received proceeds of disposition equal to the fair market value of the property. The planning adopted to avoid the consequent deemed income or gains often involves distributing appreciated assets to the beneficiaries before the 21-year deemed disposition date, provided that the distribution can be made on a tax-deferred basis pursuant to subsection 107(2). Subsection 107(5), together with subsection 107(2.1), denies the rollover when the beneficiary is a non-resident of Canada, unless the property is Canadian real property or property otherwise described in the limited exemptions in subparagraphs 128.1(4)(b)(i) to (iii).

If some or all of the beneficiaries are non-resident individuals, trustees may want to qualify for deferral under subsection 107(2) by distributing the trust's property to a beneficiary that is a Canadian-resident corporation whose shareholders are the non-resident individual beneficiaries. When the trust deed does not include corporate beneficiaries and does not contain a broad amendment power or a specific power to add beneficiaries, other planning alternatives may be considered.

The viability of alternative planning is assessed by examining two factors: (1) can the planning be implemented under the principles of trust law, and (2) would the recipient corporation have status as a "beneficiary" under the trust so that a distribution to it would be regarded as being made in satisfaction of its capital interest for the purposes of subsection 107(2). In addition, consideration must be given to the recent broad statements of the Canada Revenue Agency (CRA) about the potential applicability of the general anti-avoidance rule (GAAR) to this type of planning (CRA document no. 2017-0724301C6 and December 2019 CTF Roundtable, Q.6), which expand previous expressions of the CRA's intention to apply GAAR (CRA document nos. 2016-0669301C6 and 2017-0693321C6), unless substantial evidence supporting its non-application is provided, in the context of the distribution of trust property to corporations owned by trusts for the benefit of non-resident beneficiaries.

Variation of Trust

Consideration may be given to varying the trust to expressly provide for the inclusion as a "beneficiary" of a corporation owned by a non-resident individual or a class within which such corporation fits. The rule in *Saunders v. Vautier* (1841) Cr. & Ph. 240 provides that when all of the persons with any possible interest in a trust are in existence, legally capable (over the age of majority and mentally capable), and in agreement, these persons may terminate the trust by requiring the trustees to transfer the trust property in accordance with their direction. The better understanding of this rule is that it effectively permits a trust to be continued with such variation as is mutually acceptable to the trustees and all persons who have a possible interest in the trust. Variation of trust legislation augments the operation of this rule in circumstances when all potential beneficiaries are not able to consent to proposed changes.

The *Variation of Trusts Act* in Ontario and similar legislation in other provinces enable court approval on behalf of certain classes of beneficiaries or potential beneficiaries who are not themselves capable of consenting. The trustees enter a written deed of arrangement with all of the adult beneficiaries to vary the trust deed, and the deed is approved by a court order on behalf of all minor, unborn, and unascertained persons having a present or future interest in the trust. Pursuant to section 1(2) of the Ontario legislation, the court may approve an arrangement only if doing so appears to be for the benefit of these persons. In Ontario, as a practical matter, it would be difficult to establish that such an arrangement benefits such persons without the support of the Children's Lawyer, who represents the interests of minor and unborn persons.

The procedure for a court-approved variation of trust involves the preparation, issuance, and service of an application record outlining the reasons for the variation sought, a factum setting out its basis in law, and attendance at a hearing. To effect a trust variation, the cooperation of the trustees and all adult and ascertained beneficiaries is necessary. The Children's Lawyer should also be consulted before an application is made and provided with proposed documentation in order to discuss and possibly negotiate his or her support for the arrangement being contemplated. As well, before undertaking a variation, the trustees must have considered whether the addition of a beneficiary gives rise to tax implications, such as those that may result from a resettlement of the trust or the disposition of interests in the trust by any of its original beneficiaries (see the CRA's statements in doc. nos. 2001-0111303, 2007-0255961R3, 2010-0373401C6, and 2012-0451791E5; for criticism of this administrative position, see Roth et al., Canadian Taxation of Trusts (Toronto: Canadian Tax Foundation, 2016, at 655-58)).

Assignment of Beneficial Interest

Another way in which a distribution can be made to a Canadian corporation, even though it is not initially a beneficiary of the trust, is for the non-resident beneficiary to assign his or her interest in the trust, or entitlement to receive capital distributions from the trust, to the corporation.

Applying the "can it be done" prong of the viability test to this planning requires an analysis of whether the beneficiary of a discretionary trust has an interest that is sufficiently ascertained to be capable of transfer. In general trust law, a discretionary beneficiary has no determined property entitlement; he or she is viewed as having the right to be considered or the hope of receiving a benefit from the trust. For this reason, unless the trust deed contains an express power to assign interests thereunder, the assignment could be made by the non-resident discretionary beneficiary after the trustees have resolved to exercise their discretion in the beneficiary's favour and thereby crystallized the beneficiary's interest in the trust. Alternatively, the interest of the discretionary beneficiary may be regarded as "future property" whose assignment can be enforced by the courts of equity if the future entitlement is transferred for value. In this case, on the occurrence of the future event that crystallizes the expectancy, the interest vests in the assignee. The second aspect of the viability of this planning involves determining whether the assignee corporation becomes a "beneficiary" of the trust, thus allowing a transfer to it to qualify for rollover treatment under subsection 107(2). The CRA recently discussed this planning in the context of a technical interpretation and, on the basis of the facts reviewed, concluded that the assignee was not a beneficiary of the trust. In TI 2017-0683021I7, a trust held all of the shares of a holding corporation (Holdco) for the benefit of non-resident individuals, Y and Z (for as long as Z remained the spouse of Y) and the issue of Y. The corporate group that included Holdco implemented a reorganization that included the incorporation of a new unlimited liability company (ULC) whose common shares were issued to Y and Z. The trustees resolved to increase the stated capital of the Holdco shares and elected that a portion of the resulting deemed dividend be treated as a capital dividend, with the balance treated as a taxable dividend, both deemed paid to the trust. The trustees further resolved to distribute an equal share of the trust's assets to each of Y and Z, to the exclusion of any other beneficiary, on a future vesting date. Once the trust capital interests were fully vested, Y and Z assigned them to ULC in exchange for additional shares of ULC pursuant to asset purchase agreements on a tax-deferred basis under subsection 85(1). After the assignment, the trustees determined that the Holdco shares should be distributed to ULC.

The CRA was asked whether the trust could designate the taxable portion of the deemed dividend to ULC. The CRA concluded that

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notwithstanding the assignment, Y and Z remained the capital and income beneficiaries under the trust and that ULC was not a trust beneficiary. On this basis, the CRA made the following determinations:

- The taxable dividend allocated to ULC was a payment made for the benefit of the (income) beneficiaries, Y and Z, being the sole shareholders of ULC, and included in their income pursuant to subsection 104(13).
- The distribution of the Holdco shares to ULC was a transfer made for the benefit of the (capital) beneficiaries, Y and Z. Accordingly, pursuant to subsection 107(2.1), the trust was deemed to have disposed of the Holdco shares for fair market value proceeds.
- Part XIII withholding tax applied pursuant to paragraph 212(1)(c) to the taxable dividend allocated to ULC for the benefit of Y and Z, as well as the portion of the deemed dividend which the trustees had elected to treat as a capital dividend.
- In the event that subsection 104(13) was found not to apply to Y and Z on the basis that an amount had not become payable to them, subsection 56(2) applied to attribute to Y and Z the taxable dividend amount (deemed) paid to ULC as having been made under their direction or concurrence. Furthermore, no corresponding deduction would be available to the trust under subsection 104(6) if no amount became payable in the year to a beneficiary of the trust.
- In the event that neither subsection 104(13) nor subsection 56(2) applied to Y and Z, a benefit was conferred on ULC pursuant to subsection 105(1), and not in its capacity as a beneficiary under a trust.

In its analysis, the CRA first considered the defining characteristics of a beneficiary by reviewing the statutory definition of "beneficiary" in subsection 108(1) (a person beneficially interested in a trust), and "beneficially interested" in paragraph 248(25)(a) (any person that has any right as a beneficiary under the trust to receive any of the income or capital thereof, directly or indirectly), noting that for this purpose a beneficiary refers to "a beneficiary of a trust in the ordinary sense." The CRA reiterated its previously published position that while the determination of who is a beneficiary requires a finding of fact based on all relevant information, including the terms of the trust, "[i]n essence, a beneficiary ... is a person ... who has a right to compel the trustee to properly enforce the terms of the trust, regardless of whether that person's right ... is immediate, future, contingent, absolute or conditional on the exercise of discretion."

The CRA then focused on the terms of the trust indenture. Power was provided to distribute to "[b]eneficiaries from time to time living," thereby implying that only natural persons could be considered. The CRA noted that ULC was not specifically created or named and that no power was provided to the trustees to vary the trust or add beneficiaries, including a corporate beneficiary. It concluded that as a result of the assignment, ULC was "not thereafter a beneficiary under the Trust that has a right to compel the trustee to properly enforce the terms of the Trust."

The basis for the CRA's conclusion is difficult to ascertain. Its premise, that the trustees were unable to characterize as capital the taxable dividend deemed to have been received by the trust, is incorrect under general trust principles, which regard an increase to the stated capital account of a share held by a trust as being on capital, not income, account (unless the trust instrument specifies otherwise). (See, for example, *Re Waters/ Waters v. Toronto General Trusts Corporation et al.*, [1956] SCR 889; and *Re Hardy Official Guardian v. Toronto General Trusts Corporation et al.*, [1956] SCR 906).

The basis on which the CRA found that ULC was not a trust beneficiary following the assignment is particularly problematic. Given the CRA's imputation of a benefit to only Y and Z, and not to other discretionary beneficiaries, the CRA does not seem to be denying the ability of the trustees to fix the interests of Y and Z so that they are no longer contingent on discretion or unascertained, and seems to accept that the potential interests of other beneficiaries have been extinguished. Nor does the CRA appear to be disagreeing that the trust interests could properly be assigned. And yet, in its view, the status of neither the vendors nor the purchaser of the trust interests was affected by the asset purchase agreements, so that Y and Z did not dispose of their capital interests and ULC did not acquire them; it is therefore unclear what precisely the CRA views as having been transferred.

Because it appears that the CRA accepted that the trust interests of Y and Z were capable of transfer, it should be clear, on the basis of trust law principles, that ULC was a "beneficiary." As the CRA acknowledged, a beneficiary has two fundamental roles in the trust relationship: to receive benefit and to compel the proper administration of the trust property by the trustee. This flows from the essential nature of the trust mechanism, in which a trustee is bound with fiduciary obligations to manage property for the benefit of another. The enforcement entitlement of this other person is therefore crucial to protect his or her interest. For the relationship to make sense, there must be a person for whose benefit a court can compel the discharge of the duties impressed on the trustee.

Conversely, the holder of the rights to receive a benefit and to compel the due administration of a trust is clearly a beneficiary under the trust, even if not so defined in the trust instrument. For example, in some trusts there is no defined term referring to beneficiaries.

It is also common for a trust instrument to provide gifts over to persons if a named beneficiary is dead or not in existence at the time of distribution. These alternate recipients would be properly characterized as beneficiaries with the previously stated rights to benefit and compel administration.

It is not clear on what basis the CRA concluded that ULC had no right to compel the trustee to properly enforce the terms of the trust and accordingly was not a beneficiary. If, for example, there were a loss in value of the trust property after the assignment but before distribution, surely ULC would be entitled to inspect the books and records of the trust and hold the trustees accountable.

In addition, the terms of the trust indenture that the CRA seemed particularly focused on do not appear to be relevant to the analysis of whether an assignment of an equitable interest thereunder is possible or whether an assignee acquires the rights and interests of the assignor as a "beneficiary." While the indenture does not provide a mechanism for variation to add beneficiaries, a variation could be undertaken with court approval as described above. In terms of the distributive provision highlighted by the CRA, which contemplates only individual beneficiaries, would the CRA have reached a different conclusion if the trust interest had been assigned to an individual? Or if a variation were effected to add a class of corporate beneficiaries before the assignment was made? While a restriction on the assignment of trust interests is generally void, it would have been possible for the terms of the trust to terminate a beneficial interest thereunder on attempted alienation. Such a provision may well have been relevant to the analysis.

Most confusingly, the CRA provided an example to illustrate its analysis. If the trustees resolve to pay from the trust tuition fees to a college in which Y is enrolled, the payment would not make the college a beneficiary of the trust. While this statement is undoubtedly correct, it is difficult to see how it is analogous. There may be circumstances in which persons have the right to receive property from a trust pursuant to an entitlement other than the terms of the trust itself. As in the CRA's example, a person may be entitled to payment pursuant to a contract with the trustees. In the language of the Tax Court of Canada in *Chan v. The Queen*, 99 DTC 1215 (TCC), appeal dismissed 2001 DTC 5570 (FCA), a payment made by trustees in exchange for consideration is "inconsistent with" receipt of the property as a beneficiary. The payment to the college in the CRA's example is in the college's capacity as a creditor of the trust. If instead the college were named as a beneficiary in the trust deed or acquired the rights of a beneficiary, it would be a beneficiary with respect to payments to it made by the trustees in accordance with their fiduciary duty or obligation, notwithstanding Y's enrollment.

Conclusion

The CRA's comments on the potential application of GAAR to distributions made to corporate beneficiaries owned by one or more non-resident shareholders are troubling, particularly in light of the fact that the CRA has previously ruled that including a corporation in the class of beneficiaries would not be challenged under GAAR (see CRA document nos. 9719943 and 2008-0267251R3). In CRA document no. 2017-0724301C6, the CRA extended its previous position, adopted in connection with distributions to Canadian corporations owned by trusts, on the basis that distributions to Canadian corporations owned by non resident individuals circumvent the application of subsection 104(5.8) as well as subsections 107(5) and (2.1) and frustrate or defeat the "object, spirit or purpose of those provisions, subsections 70(5), 104(4) and 107(2) and the Act as a whole" by contravening "one of the underlying principles of the taxation of the capital gains regime which is to prevent the indefinite deferral of tax on certain gains." At the December 2019 CTF, the CRA confirmed its view that the GAAR is applicable upon distribution to such corporate beneficiaries of taxable Canadian property unless it fit within the specific carve outs from subsection 107(5). Such extensions are difficult to reconcile with the fact that the distributed property will ultimately be subject to Canadian tax on its disposition by the corporate beneficiary. Moreover, if the shares of the Canadian corporation are taxable Canadian property, the non-resident shareholder may be subject to tax at death on any gain arising from the deemed disposition of the shares. If the shares are not taxable Canadian property, there appears to be no policy reason for Canada to tax the gain in any event. In these circumstances, the provisions, including the subsection 107(2) rollover, function exactly as intended on the distribution of capital property to a Canadian-resident corporate beneficiary under the trust.

The basis for the CRA's more recent administrative position on the assignment of a beneficial interest to a corporation discussed in this article also appears to be inconsistent with both trust law principles and the applicable provisions of the Act. These interpretations create considerable uncertainty for trustees of trusts with non-resident beneficiaries approaching the 21-year deemed disposition date, who may be required to attempt to reconcile the CRA's position in these published interpretations with the application of the relevant legal principles to their specific facts. In the absence of a principled basis underlying the CRA's reasoning, trustees will find such a reconciliation difficult to achieve in many cases.

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The Trouble with Post Mortem Pipelines for Non-Resident Beneficiaries

HENRY SHEW, TEP
Cadesky Tax
Member, STEP Toronto

Significant changes were made to section 212.1 of the *Income Tax Act* to prevent non-residents from stripping surplus and eroding the Canadian tax base. These changes include lookthrough rules for trusts that apply in respect of dispositions that occur after February 26, 2018, the 2018 budget date. Because of these changes, pipeline transactions involving a trust or an estate with non-resident beneficiaries do not prevent double taxation as a result of the post mortem deemed disposition of shares of a corporation or an interest in partnership units.

The initial draft changes to section 212.1, which were released on July 27, 2018, excluded trusts from the lookthrough rule on the dispositions of shares or partnership interests and did not interfere with pipeline transactions involving non-resident beneficiaries. However, the lookthrough rule for trust dispositions was included in the second version of the draft legislation, which was released on October 25, 2018 and became law on December 13, 2018. As illustrated in this article, pipeline transactions now result in double taxation. Recently, the author of this article received a comfort letter from the Department of Finance, proposing a recommendation to Parliament to exclude graduated rate estates, though not special purpose trusts, from the operation of section 212.1. An announcement of this proposal was made at the Canadian Tax Foundation's 2019 annual conference.

Background

In Canada, shareholders can receive a tax-free payment from Canadian corporations equal to the corporation's paid-up capital (PUC). In general, PUC represents the amount of capital that has been contributed by shareholders. Distributions that exceed PUC are deemed to be dividends in the hands of shareholders. For non-resident shareholders, the deemed dividend attracts part XIII tax of 25 percent, subject to reduction of the withholding rate under a tax treaty.

Section 212.1 is designed to prevent a non-resident shareholder from entering into transactions to remove surplus in excess of PUC tax-free from a Canadian corporation or to artificially increase the PUC of shares. Section 212.1 deems the non-resident shareholder to have received a dividend equal to the amount of surplus that exceeds PUC. The new PUC of the purchaser corporation that is created as part of the transaction is reduced to the original PUC of the subject corporation.

In the 2018 federal budget, the government raised the concern that non-resident taxpayers have circumvented the rules in section 212.1 by using conduit entities, such as partnerships and trusts. Under the old rules, section 212.1 applied when a partnership (referred to as "a designated partnership") was a vendor that disposed of shares of a subject corporation to a purchaser corporation. However, the rules did not address situations in which a non-resident person disposed of shares of a subject corporation to a partnership, and then disposed of the partnership interests to a purchaser corporation. The government was concerned that these transactions could also be implemented through the use of trusts.

Section 212.1 contains lookthrough rules that deem a disposition made by a conduit, such as a trust, to be a disposition made by a beneficiary of the trust, which can be a non-resident person. As a result, section 212.1 applies to deem the non-resident beneficiary to have received a deemed dividend, which is subject to Canadian withholding tax.

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Pipeline Transactions

A pipeline transaction occurs when a taxpayer transfers shares of a subject corporation with a high cost base to a purchaser corporation in exchange for shares and non-share consideration (boot) of the purchaser corporation. The objective of a pipeline transaction is to avoid a second level of tax when tax has already been paid on a previous transaction that resulted in the high cost base of the shares of the subject corporation. Below are two fact situations in which a pipeline transaction produces a second level of tax under section 212.1.

Fact Situation 1: Estate and Section 212.1

An estate has three beneficiaries: John and Vicky, who are Canadian residents, and Sandy, who is a non-resident. The will provides that the net assets (after payment of liabilities) are to be divided equally among the three beneficiaries. The estate owns shares of a corporation (Opco) with an adjusted cost base of $100,000 (from the deemed disposition at death) and PUC of $100. Each beneficiary is to receive one-third of the shares.

What happens to Sandy if the estate implements a pipeline transaction?

Section 212.1 applies, and Sandy is deemed to have received a dividend of $33,300 (one-third of the difference between the promissory note and the PUC). Section 212.1 applies because Sandy and the purchaser corporation (Holdco) do not deal at arm's length. Under subparagraph 212.1(3)(b)(ii), Sandy is deemed to own the shares that the trust owns on the basis of her proportionate interest in the trust. Additionally, paragraph 212.1(3)(a) states that a non-arm's-length relationship is established if the non-resident person is part of a group of fewer than six persons that controls both Opco and Holdco.

Section 212.1 defeats the purpose of a pipeline transaction because it introduces a second level of tax. Even if Sandy does not receive the shares of Opco and instead receives other property of the estate in satisfaction of her one-third interest, the section nonetheless applies.

What happens if the executor has the power to choose which assets to distribute to each beneficiary when the assets are held both inside and outside the estate?

The practice of taking into consideration assets that are distributed from inside and outside the estate is known as "activating the hotchpot clause." This is a common practice in estate planning, especially when assets are passed outside the estate to save probate tax. For example, life insurance proceeds and registered account assets, such as registered retirement savings plans and tax-free savings accounts, often have designated beneficiaries and are distributed outside the estate.

The consequence of such an otherwise effective estate-planning technique is that a pipeline transaction involving a non-resident beneficiary attracts a penalizing tax under subsection 212.1(7). Subsection 212.1(7) is an anti-avoidance provision that

deems section 212.1 to apply when the executor has a discretionary power; it operates to prevent the attribution of ownership of the shares to the non-resident or any other beneficiary. If subsection 212.1(7) is applicable, Sandy is deemed to own 100 percent of the trust's assets. This means that a deemed dividend to Sandy would be tripled to $99,900 ($100,000 minus $100). Subsection 212.1(7) contains a purpose test, which is met when avoidance of the application of the deemed dividend in subsection 212.1(1.1) is merely one of the reasons for granting the discretionary power to the executor.

> If the executor is allowed to choose which assets go to each beneficiary but is obliged to distribute the assets proportionately by value, subsection 212.1(7) does not apply because the executor does not have the discretion to alter the value that can be passed to the non-resident beneficiary.

If the executor is allowed to choose which assets go to each beneficiary but is obliged to distribute the assets proportionately by value, subsection 212.1(7) does not apply because the executor does not have the discretion to alter the value that can be passed to the non-resident beneficiary. However, a deemed dividend of $33,300 is still attributed to Sandy, regardless of whether Sandy receives the Opco shares.

Fact Situation 2: Special Purpose Trusts and Section 212.1

At age 65, Yvonne sets up an alter ego trust with one non-resident beneficiary, Daniel. On Yvonne's death, the alter ego trust is deemed to have disposed of all of its assets (including shares of private corporations) at fair market value under subsection 104(4). Subsection 104(6) provides that the gain that arises because of the deemed disposition in subsection 104(4) cannot be allocated to any beneficiaries, including Daniel. Formerly, an election in subsection 104(13.4) allowed the gain to become payable to the deceased instead of being taxed in the alter ego trust. However, since 2017 this election is no longer available. As a result of subsections 104(6) and (13.4), tax on the deemed disposition of assets on the death of Yvonne must be paid by the alter ego trust. Daniel consequently acquires the shares at their fair market value at that time.

In the past, the trustee could benefit Daniel by implementing a pipeline transaction to avoid a second level of tax when extracting funds from the corporation. However, section 212.1 now applies and a deemed dividend arises because Daniel is a non-resident. Two levels of taxes must be paid: one by the alter ego trust as a result of the deemed disposition on the death of the settlor, Yvonne, and the second as a result of the deemed dividend to the non-resident beneficiary, Daniel.

The same tax implications apply to all special purposes trusts described in paragraphs 104(4)(a), (a.1), and (a.4), which include alter ego trusts, spousal or common-law partner trusts, joint spousal trusts, joint partner trusts and self-benefit trusts.

As indicated above, new section 212.1 applies to dispositions made after February 26, 2018. However, there was no mention of the look-through rule in the budget announcement or the initial draft legislation released on July 27, 2018. The rule was included for the first time in the October 25,, 2018 version, which ultimately became law. There is a retroactive element to the new rules that negatively affects pipeline transactions, despite the fact that the Canada Revenue Agency has provided numerous favourable rulings for these transactions in the past. Trusts and estates that implemented pipeline transactions after the budget date, when they were unaware of the new rules, will be liable for the payment of penalties and interest because withholding tax for the deemed dividend would unlikely have been paid on the 15th day of the following month.

The Department of Finance is now aware of the double taxation resulting from the new lookthrough rule for trusts in section 212.1. Finance has released a comfort letter to recommend to Parliament to exclude graduated rate estates, though not special purposes trusts, from section 212.1. As of the date of writing of this article, no draft legislation has been released yet. It is hoped that Parliament will soon enact relieving provisions.

Thorny Income Tax Issues for US Beneficiaries of Canadian Trusts

CATHERINE B. EBERL
Hodgson Russ LLP

Trustees of Canadian trusts with US beneficiaries face complications on both sides of the border. In some cases, the Canadian and US rules can be substantially dissimilar. For example, a trust may be a taxpayer in Canada but a disregarded entity in the United States because it is considered to be a grantor trust. Alternatively, a distribution to a beneficiary may be deemed to have occurred in Canada but the funds may be considered to remain in the trust for US tax purposes. Both of these examples could result in a mismatch of the incidence of tax and the potential for double taxation that is not resolved under the Canada-US tax treaty.

This article is intended to assist Canadian advisers by reviewing certain US issues that commonly arise when a non-resident (Canadian) trust has US beneficiaries (who may be resident in Canada).

Grantor Trusts

The first step in averting potential complications involves identifying the type of trust at issue: is it a grantor trust or a non-grantor trust for US tax purposes? Generally, a trust is a grantor trust if the trust agreement gives the grantor or trustee certain types of powers over the trust assets. The trust creator, or grantor, is treated as directly owning the assets of the trust. All income, gains, losses, and deductions are reported on the grantor's personal income tax return. The trust itself is not subject to income tax, and is essentially a disregarded entity in the United States. On the death of the grantor, the trust changes into a non-grantor trust.

The grantor of the trust is the individual who makes a gratuitous transfer to the trust. If multiple individuals make gratuitous transfers to the trust, there are multiple grantors, and each is taxed on the trust's income in proportion to his or her contribution to the trust. The person who is listed on the title page of the trust agreement is not necessarily a grantor. The Internal Revenue Service (IRS) looks to who actually made a gratuitous transfer to the trust. For example, if attorney Singh signs the trust agreement as settlor and settles the trust with $1, and a month later client Jones contributes $1 million to the trust, client Jones is deemed to be the grantor of the trust.

> The first step in averting potential complications involves identifying the type of trust at issue: is it a grantor trust or a non-grantor trust for US tax purposes?

There are many circumstances in which a trust is treated as a grantor trust. However, most of the triggers operate only if the person who is to be treated as the grantor is a citizen or resident of the United States. A trust created by someone who is neither a US citizen nor a US resident is considered to be a grantor trust in only two situations: (1) the only distributions that can be made during the lifetime of the grantor are distributions made to the foreign grantor or his or her spouse, or (2) a foreign grantor has the right to "revest the trust assets" in himself or herself, either unilaterally or with the consent of a related or subordinate party who is not adverse. An "adverse party" is someone with a beneficial interest in the trust. Someone is "related or subordinate" if he or she is a family member within a certain degree of the grantor or is an employee of the grantor.

As a practical matter, for a trust to be a foreign grantor trust under point (2) above, the grantor must be a beneficiary of the trust (there can be others as well), and the trust distribution provisions must be fully discretionary. The grantor must be a trustee and/or have a unilateral power to withdraw trust assets at any time. Alternatively, if the grantor serves with a co-trustee and does not have a unilateral withdrawal power, the co-trustee cannot be another trust beneficiary, and must be someone who is considered to be related or subordinate.

Distributions from a Foreign Grantor Trust to a US Beneficiary

Designation as a foreign grantor trust is desirable because the United States ignores grantor trusts, the US beneficiary is not treated as a trust

beneficiary, and all of the beneficiary's cross-border complications disappear. The grantor is treated as owning all of the trust assets directly, and therefore the United States treats all of the trust income as earned by and taxed in the hands of the grantor directly. When a trust is not a US grantor trust, the United States has no authority to tax the trust grantor unless the trust has US-source income. When distributions are made to the US beneficiary, income is not considered to be received by the US beneficiary and tax is not exigible from the US beneficiary. Rather, the US beneficiary is treated simply as having received a gift from the grantor.

Because the trust is ignored for income tax purposes, the throwback tax regime does not apply as long as the trust remains a foreign grantor trust. (See a discussion of the throwback tax regime below.) Further, the US beneficiary is not subject to the complicated controlled foreign corporation (CFC) and passive foreign investment company (PFIC) rules while the trust is a foreign grantor trust because the Canadian trust grantor is treated as owning the corporation shares directly. On the death of the grantor, when the trust ceases to be a foreign grantor trust, all US beneficiaries must evaluate whether the CFC and PFIC rules apply, and to what extent the trust's share ownership is attributable to them because of their beneficial interest in the trust.

Distributions from a Non-Grantor Trust to a US Beneficiary

If a trust ceases to be or never was a grantor trust, it is a regarded entity for US income tax purposes; the trustee and US beneficiary must therefore analyze the US tax implications.

A non-grantor US trust that makes no distributions in a given year pays tax on all of its income. Unlike the situation in Canada, it is impossible to disperse trust income unless a trust distribution is actually made.

If a non-grantor trust makes distributions, the trustee must determine how much of the trust's income is to be distributed to the beneficiaries and taxed in their hands, and how much of the trust's income is to remain in the trust and be taxed there. To make this determination, the trustee must calculate the trust's distributable net income (DNI) for the year. DNI generally includes all of a trust's taxable income, which in the case of a non-US trust, will include the trust's capital gains. Tax-exempt income is excluded from DNI.

The trustee must then calculate the amount of the distribution deduction that the trust must claim for the distributions made to beneficiaries. The distribution deduction is the amount distributed to the beneficiaries, capped at the trust's DNI. In turn, the beneficiaries include in income their pro rata share of the distribution deduction.

These income inclusion rules apply to US beneficiaries, regardless of whether the trust is a US trust or a foreign trust. If the trust is a US trust, the beneficiaries receive a schedule K-1 from the trust that shows the amounts that must be included and the character of the different types of income. If the trust is not a US trust, the US beneficiaries must either request that the trustee run a pro forma US income tax return so that they can determine the includible amount, or must obtain the tax-reporting information from the trustee and determine the tax consequences themselves.

As an example, assume that in the first year of its existence, a Canadian trust earns $200 of taxable interest income and $5,000 of dividends, and is able to claim a $2,000 deduction for trustee's fees. Cohen, a beneficiary who is a US citizen, receives a $1,000 distribution from the trust; the total amount of distributions to all beneficiaries is $4,000. Cohen must determine how much of the $1,000 is included in his taxable income for US income tax purposes. To do so, the trustee must determine that the trust's DNI is $3,200. The distribution deduction for the year is also $3,200. Because Cohen receives $1,000 of the $4,000, one-quarter of the trust's income is deemed to pass to him. Accordingly, Cohen reports $800 of income on his personal income tax return ($31 as interest income and $769 as dividends).

In this example, the trust is in its first year, and therefore the US tax on accumulation distributions made from a foreign non-grantor trust to a US beneficiary (called "the throwback tax") is inapplicable. However, as the trust ages, the US beneficiary must determine whether the throwback tax applies. The throwback tax is essentially an anti-deferral device that penalizes a beneficiary for trust income that is left offshore in the trust, where it is not subject to US income tax, as opposed to being distributed to the US beneficiary and therefore subject to US tax in the year it is earned.

A distribution from the trust may be subject to the throwback tax in any year in which a distribution to a US beneficiary exceeds the greater of the trust's DNI or its accounting income. To determine if the throwback tax applies, the US beneficiary must determine whether the trust has undistributed net income (UNI) from prior years. Essentially, if the trust had undistributed DNI in a prior year, the undistributed DNI becomes UNI.

> A distribution from the trust may be subject to the throwback tax in any year in which a distribution to a US beneficiary exceeds the greater of the trust's DNI or its accounting income.

UNI that is distributed in a later year is deemed to be an accumulation distribution (that is, a distribution of the prior year income that has built up in the trust). Using a complicated formula, the details of which are beyond the scope of this article, the US beneficiary must calculate the tax due on the accumulation distribution. All UNI is taxed as ordinary income; to the extent that the income is a capital gain that would have been taxed at a lower rate in the prior year, the deferral of the tax can result in a significantly greater tax burden than if the capital gain had been distributed in the year it was recognized by the trust. Further, because the tax is deemed to relate to a prior year's income, interest is charged on the accumulation distribution.

Reporting

No article about US income tax would be complete without a discussion of the onerous reporting requirements that apply to the trust's US beneficiaries. A US beneficiary who receives a distribution from a Canadian trust must file form 3520 to report the distribution to the IRS. If the US beneficiary receives a distribution of more than 50 percent of the trust's current income, the beneficiary must file FinCEN form 114, Report of Foreign Bank and Financial Accounts (also known as, the FBAR). In addition, in any year that the beneficiary receives a distribution from the trust, the beneficiary must review whether it is necessary to file a form 8938, which is required when the value of the beneficiary's financial interest in the trust exceeds the reporting threshold.

IN THE HEADLINES

ADEQUATE, JUST, AND EQUITABLE PROVISION: A REVIEW OF GREWAL V. LITT

KATE S. MARPLES, TEP
Legacy Tax + Trust Lawyers; Member, STEP Vancouver

JEFFREY BICHARD
Legacy Tax + Trust Lawyers; Student member, STEP Vancouver

The recent Supreme Court of British Columbia decision in *Grewal v. Litt*, 2019 BCSC 1154, concerned a wills variation claim involving two wills. While all parties agreed that the wills in question should be varied, they did not agree with how the wills should be varied. Adair J's decision attempts to balance the testamentary autonomy of the will makers with the need to provide adequate, just, and equitable provision for the claimants.

British Columbia's dependants relief legislation is contained in section 60 of the *Wills, Estates and Succession Act*. Section 60 provides that "if a will-maker dies leaving a will that does not, in the court's opinion, make adequate provision for the proper maintenance and support of the will-maker's spouse or children, the court may, in a proceeding by or on behalf of the spouse or children, order that the provision that it thinks adequate, just and equitable in the circumstances be made out of the will-maker's estate for the spouse or children." There is no requirement for dependency on the part of the claimants.

In *Grewal*, Mr. and Mrs. Litt died within several weeks of each other. The value of their collective estates at the time of trial was approximately $9 million. Mr. and Mrs. Litt had mirror wills, which left everything to each other, and, on the death of the second to die, made gifts of $150,000 to each of their four daughters (approximately 6 percent of the collective estate), with the residue of their estate (approximately 94 percent of the collective estate) to be divided equally between their two sons. The four daughters brought a claim to vary their parents' wills on the basis that the wills did not make adequate provision for them.

The decision provides an extensive overview of the evidence presented to the court as well as a discussion about the credibility of the witnesses. Adair J consulted the applicable case law and focused on six factors that were relevant in examining the will makers' moral duty to their independent adult children: (1) gifts and benefits provided by the parents to their children outside the wills, (2) the parents' reasons for making the relevant provisions for their children, (3) the reasonably held expectations of the children, (4) the contributions made by the children to the family farming business, (5) the contributions made by the children toward their parents' care, and (6) the personal circumstances of the children.

Ultimately, Adair J concluded that the parents had given considerably larger gifts to their sons than to their daughters during their lifetimes. She also found that traditional cultural values had affected the way in which the parents treated their daughters, both in their wills and during their lifetimes; however, the daughters nonetheless had a reasonable expectation of receiving a greater portion of the estate than was reflected in the wills as a result of comments made to them during their lifetimes. Finally, Adair J found that the moral obligation owed by the parents to the daughters was enhanced by the daughters' significant contribution toward the parents' care, which was necessary because of the ongoing and substantial health problems suffered by the parents in later life. Not all of the daughters made an equal contribution in this way.

The parties proposed several different methods for variation, including differing treatment for each child. Ultimately, however, the court rejected this approach. Instead, it found that treating the daughters equally as among themselves, and treating the sons equally as among themselves, while not necessarily treating each child equally, supported the testamentary autonomy of the will makers because it was consistent with the approach in the original wills.

In the result, Adair J varied the wills, dividing 60 percent of the residue among the four daughters (15 percent of the collective estate each) and 40 percent of the residue among the two sons (20 percent of the collective estate each).

Grewal sets out a thorough review of the factors to be considered in a wills variation case when a dispute exists among independent adult children and provides an interesting analysis of how these factors coincide with considerations of testamentary autonomy.

CASE COMMENT

NANCY L. GOLDING, TEP

Borden Ladner Gervais LLP; Member, STEP Worldwide Board; Member, STEP Calgary

Use and Abuse of Advice and Direction Applications

An issue of increasing concern for the courts of Alberta is the use, misuse, and even abuse of applications for advice and direction. Personal representatives and trustees often apply for remedies, including declaratory relief and the interpretation of trusts and testamentary documents, under the pretext of making an application for the court's advice and direction.

In Alberta, an application for advice and direction is made either pursuant to section 43 of the *Trustee Act* or section 49 of the *Estate Administration Act*. Section 43(1) of the *Trustee Act* states that "[a]ny trustee may apply in court or in chambers in the manner prescribed by the rules of court for the opinion, advice or direction of the Court of Queen's Bench on any question respecting the management or administration of the trust property." A trustee includes a personal representative of an estate.

The benefit of such an application is apparent in section 43(2), which provides protection for a trustee who acts on the advice given by a court. The existence of this statutory protection is one of the reasons why these applications have become so popular in recent years. Section 43(2) states that "[t]he trustee acting on the opinion, advice or direction given by the Court is deemed, so far as regards the trustee's own responsibility, to have discharged the trustee's duty as trustee in respect of the subject matter of the opinion, advice or direction."

The provisions in the *Estate Administration Act* are similar and provide similar protection. Given the clogged court system and the delays involved in obtaining dates for special applications, hearings, and trials, many practitioners try to squeeze pressing matters into an advice and direction application for consideration by a court in morning chambers.

On such an application, the court has no obligation to provide the advice and direction requested; rather, it lies within the court's discretion to do so or not. The courts in Alberta are, often quite rightly, refusing to provide the relief requested when providing this relief would determine the substantive rights of the parties and when the advice sought does not relate to the administration of a trust or estate.

The legislation will in proper circumstances protect a personal representative or trustee from liability; however, it is not the intention of the legislation to bind parties whose substantive rights are affected, or determined, by the advice provided by a court to a personal representative or trustee.

The Court of Queen's Bench most recently considered this issue in *Eng*

An issue of increasing concern for the courts of Alberta is the use, misuse, and even abuse of applications for advice and direction. Personal representatives and trustees often apply for remedies, including declaratory relief and the interpretation of trusts and testamentary documents, under the pretext of making an application for the court's advice and direction.

Family Trust v. Eng, 2019 ABQB 758. In this case, MNP Ltd., which was acting as a trustee, brought an application for advice and direction pursuant to the *Trustee Act*. It presented the court with "a whole laundry list of questions," including a number of hypothetical questions. In considering the application, the court commented that "[t]here has been some tension between the extent to which [the legislation] should be used when there are contentious matters between parties and rights to property are in issue."

Nation J reviewed the purpose of the advice and direction application sections in the *Trustee Act*, citing *Re Tomlinson Estate*, 2016 BCSC 1223, and commented that in *Re Tomlinson Estate* "reference was made to the equivalent British Columbia legislation as being designed to enable the Trustee in 'little matters of discretion,' or 'the management and investment of trust property,' but not as the basis of applications to construe an instrument or to affect the rights of the parties to property."

Nation J also quoted from *Waters' Law of Trusts in Canada*, 4th ed. (Toronto: Carswell, 2012) at 1164:

> The issue of "management or administration" as a limitation upon the *Trustee Act* power of the court to give its opinion, advice, or direction has been more particularly raised in connection with motions which turn out to involve a conflict as to ownership of the assets. The courts refuse to give such assistance when there is essentially a conflict between interested parties, and this is not merely because the court has not the necessary evidence before it, but because it is felt that a "fight," whether or not it is patent, is not a matter of management or administration.

The legislation focuses on courts helping trustees to administer a trust by providing advice, not in respect of conflicting parties but in respect of the obligations of the trustees.

The court in *Eng Family Trust* declined to answer a number of the questions raised in the application because the questions did not properly fall within an advice and direction application. It did note, however, that it could assist with contentious matters by determining the procedure by means of which these matters could be resolved.

This case provides guidance for practitioners about the proper use of advice and direction applications while cautioning practitioners about the strict approach that the courts of Alberta are currently taking.

NEW INTESTATE SUCCESSION LEGISLATION IN SASKATCHEWAN

AMANDA S.A. DOUCETTE, TEP
Stevenson Hood Thornton Beaubier LLP; Member, STEP Saskatchewan

On October 1, 2019, *The Intestate Succession Act*, 2019 was proclaimed in force in Saskatchewan, following a multiyear consultation process undertaken by the Law Reform Commission of Saskatchewan.

The new Act introduces the following key changes from the previous regime:

- It refers to "descendants" as opposed to "issue" (section 2).
- If all descendants are "common descendants" of both the intestate and the spouse of the intestate, the spouse now receives the entire estate, to the exclusion of the children (section 5).
- If any of the descendants are not "common descendants," the spouse receives a preferential share, as well as a share in the residual estate of the intestate (section 6). The amount of the preferential share has increased to $200,000 (from the previous $100,000) and is now set out in the regulations.
- The doctrine of advancement was removed from the new Act, which places beneficiaries on an equal footing, regardless of whether the deceased dies with or without a will.

The laws of Saskatchewan apply to the distribution of immovable property located in Saskatchewan, regardless of whether the intestate resided outside the province at the time of death (section 16).

The Act continues to recognize the rights of descendants and relatives of the intestate who are born after the death of the intestate but not the rights of descendants and relatives of the intestate who are conceived after the death of the intestate. (section 12).

There are three key challenges that arise from the language in the Act, all of which relate to the treatment of spouses.

First, although the Act attempts to clarify the immovable property rules as they relate to intestacy, arguably the new language presents the opportunity for a spouse to receive a preferential share under the legislation of at least two different provinces.

Second, the Act attempts to deal with the issue of multiple spouses, an issue that can arise when a couple separates and one of the spouses enters into a new spousal relationship. The Act clarifies that if there is a separation (as a result of a legal agreement or the passage of time), or if the intestate and the spouse were parties to a proceeding under the federal *Divorce*

Act or Saskatchewan's *The Family Property Act* or *The Family Maintenance Act*, the spouse takes no part in the estate.

However, *The Intestate Succession Act*, 2019 also states that "[i]f the spouse of an intestate has left the intestate and is cohabiting with another individual in a spousal relationship at the time of the intestate's death," the spouse does not take any part in the estate of the intestate (section 15(3)). At first glance, this provision appears to remedy the problem of multiple spouses without the need for waiting 24 months (or entering into formal legal proceedings). However, the language suggests that the entitlement of the spouse is dependent on the actions of the spouse. A spouse who leaves the relationship with the intestate and enters into a new relationship has no rights in the intestate's estate. However, an intestate who enters into a new relationship does not appear to be caught by this provision. Further clarification is required.

> The laws of Saskatchewan apply to the distribution of immovable property located in Saskatchewan, regardless of whether the intestate resided outside the province at the time of death.

Third, it is necessary to consider how the definition of "spouse" in *The Intestate Succession Act*, 2019 interacts with the treatment of spouses in *The Administration of Estates Act*. Could a person be considered to be a spouse for the purpose of administering an estate, but not a spouse for the purpose of receiving a share of the estate on an intestacy?

In addition to the changes respecting the treatment of "spouses" in *The Intestate Succession Act*, 2019, the Saskatchewan government has recently announced proposed changes to *The Wills Act*, 1996 and *The Marriage Act*, 1995 (not yet enacted), including the removal of the clause that revokes a will on marriage or cohabitation and the inclusion of new provisions that purport to deal with predatory marriages. The interaction of these proposed changes with the treatment of spouses in *The Intestate Succession Act*, 2019 should be considered.

O, WHAT A TANGLED WEB WE WEAVE…

KATY BASI, TEP
Basi Law; Member, STEP Toronto

Sibling disputes are often messy, particularly when legal title to an asset is held by one sibling and beneficial ownership is held by another. In *Syrnyk v. Syrnyk*, 2019 ONSC 225, brotherly affection eroded and litigation ensued.

Legal title to a home in Wasaga Beach was registered in the name of Richard, but Richard's brother Ronald had lived there with his partner since 2009. Petersen J found that Richard held title to the home on a resulting trust for the benefit of Ronald, stating that a resulting trust is presumed to arise when title is "gratuitously transferred from one person to another without any consideration given or where a person supplies the entire purchase price for the property, but title is taken in another person's name."

Ronald paid a deposit to the builder of the home and entered into the purchase agreement, but he could not obtain mortgage financing. The brothers had a verbal agreement that Richard would obtain the mortgage, and Ronald would pay all mortgage amounts, utility bills, and other expenses relating to the home. The court held that the down payment for the home, paid by Richard on closing in 2006, was a loan from Richard to Ronald, and was repaid by Ronald in 2009. There was no evidence that Ronald intended to make a gift of the home to Richard, which would have rebutted the presumption of a resulting trust.

There were a number of occurrences relating to the home that added friction to the brothers' relationship, thereby leading to the litigation:

- The arrangement was supposed to be a short-term one, but it lasted for more than a dozen years. The court found that Richard acquiesced to an indefinite extension of the trust arrangement.
- Richard attempted to demand "fees" from Ronald for holding the mortgage and an indemnity for any capital gains tax that Richard might owe relating to the home. The brothers had contemplated neither the fees nor an indemnity when they initially entered into their arrangement.
- In 2011, Richard renewed the mortgage. Without Ronald's consent, Richard increased the principal by approximately $10,000, and kept the increase for himself.
- Richard refused Ronald's request to increase the principal of the mortgage by $25,000 to permit a basement renovation. During an argument, Richard indicated that

he would not transfer the home to Ronald or Ronald's children.

- Because of Ronald's default, Richard paid the property taxes from 2014 onward, the home insurance premiums from 2013, and the mortgage from 2016.
- Richard's lawyer threatened to have Ronald evicted if he neither bought nor vacated the home.
- Richard threatened to call the township concerning the modifications that Ronald made to the home because he suspected that Ronald had not obtained building permits.

In a summary judgment, Petersen J found that Richard committed a breach of trust by acting "in his own self-interest rather than in Ronald's best interest" and disallowed any claim by Richard for compensation or for an indemnity relating to potential capital gains tax. He also ordered Ronald to reimburse Richard for all expenses properly incurred by Richard relating to the home, less a setoff for the equity that Richard extracted from the home. Finally, because the trust arrangement clearly needed to be terminated, the court ordered that Ronald would assume the mortgage from Richard or discharge it, at which time legal title to the home would be transferred to Ronald. If Ronald failed to assume or discharge the mortgage, Richard would sell the home on the open market, reimburse himself for his verified expenses less the setoff, and transfer the remainder of the proceeds to Ronald.

Practitioners may scratch their heads at the income tax implications of the brothers' arrangement. Richard incorrectly declared on his tax returns that the home was his investment property (given the court's ruling, Richard presumably should have filed a tax return for the resulting trust for any year in which rental income was earned on the home). The court concluded that Richard had enjoyed a significant tax advantage by reporting rental losses from the home over the years (created, in Petersen J's words, from "fictional rental income" and "non-existent expenses"). In addition, Richard was concerned about capital gains tax relating to the home, and this concern exacerbated the difficulties between the brothers.

> Sibling disputes are often messy, particularly when legal title to an asset is held by one sibling and beneficial ownership is held by another.

Until October 2016, it was possible for a resulting trust to claim the principal residence exemption if a number of conditions were met, thereby reducing potential capital gains tax. The trust in question may have met these conditions for many years because Ronald lived in the home from 2009 onward. Therefore, one of the main reasons for this litigation, being the potential for capital gains tax, may have been minimized had the brothers received good tax advice when they entered into the arrangement. (Current tax law is different and would require a bare trust arrangement to obtain a similar tax result under these circumstances). Instead, a verbal arrangement was made with no expert advice, and neither party completely upheld his part of the bargain. Over a decade of turmoil ensued. Unfortunately, it is very common for clients to make family arrangements concerning the ownership of their assets. This cautionary tale should encourage advisers to urge their clients to obtain the expert advice required to ensure that a family arrangement does not in fact break a family apart.

WHO PAYS THE TAX ON THAT BEQUEST?

JENNIFER LEACH
Associate, Sweibel Novek LLP

In two recent decisions, the Quebec Court of Appeal considered the question of who was liable to pay the tax on a particular bequest, the estate or the legatee. *Picard c. Succession de Lagotte*, 2019 QCCA 254, and *L'Agence du revenu du Québec c. Teitelbaum*, 2019 QCCA 1408, highlight the importance of reviewing the tax implications of specific bequests for all parties with the testator.

Following the death of his wife, Marguerite Lagotte, Sylvain Picard accepted two particular bequests under the will: the couple's residence and a rental property on which there was a substantial accrued capital gain. M. Picard was neither a residual beneficiary nor the liquidator of his wife's estate.

The liquidator transferred the properties to M. Picard on a spousal rollover basis, pursuant to subsection 70(6) of the *Income Tax Act* (ITA) and article 440 of the Quebec Taxation Act (QTA). M. Picard objected to this tax treatment, arguing that under article 739 of the *Civil Code of Québec* (CCQ) he should receive the property at fair market value and not at its adjusted cost base. Article 739(2) CCQ provides that legatees by particular title are not liable for the debts of the deceased on the property of the legacy unless the other property of the succession is insufficient to pay these debts.

The Quebec Superior Court rejected this argument, referring to the importance of a clause in Ms. Lagotte's will that gave the liquidator the discretion to make tax elections for the benefit of any one or more legatees or of the estate. In this case, the liquidator chose to transfer the rental property to M. Picard on a rollover basis to the advantage of Ms. Lagotte's estate and the residual beneficiaries. The court held that this was a valid and appropriate exercise of the liquidator's discretion.

M. Picard then argued that he could not receive the property on a rollover basis pursuant to subsection 70(6) ITA because the bequest was conditional on his surviving his wife for 30 days. The court dismissed this argument, finding that the property had vested indefeasibly in M. Picard on the 30th day after his wife's death.

The Court of Appeal upheld the decision of the lower court in its entirety, confirming that the properties were properly transferred to M. Picard on a rollover basis.

In *Teitelbaum*, Carole Teitelbaum had received a payment of $1.4 million under the terms of her late spouse's retirement compensation agreement (RCA). Ms. Teitelbaum received the payment two years after her spouse's death. Her spouse's will had designated Ms. Teitelbaum as the beneficiary of "all pension plans and any annuities purchased therefrom."

The parties agreed that the payment from the RCA represented a right or property pursuant to article 429 QTA (the equivalent of subsection 70(2) ITA). However, because the funds were not distributed to her within one year of her spouse's death, pursuant to article 430 QTA (the equivalent of subsection 70(3) ITA), Ms. Teitelbaum did not consider them to be taxable in her hands.

By contrast, the Agence du revenu du Québec (ARQ) determined that the will designated Ms. Teitelbaum as a beneficiary of a retirement plan pursuant to articles 2379 and 2446 CCQ; she had therefore received the property directly on the death of her spouse and not as a transfer from his estate.

The Court of Quebec disagreed with the ARQ, finding that while the RCA may have been a retirement plan under article 2379 CCQ, it did not constitute an annuity under article 2367 CCQ. It therefore could not give rise to a beneficiary designation under the CCQ. Rather, Ms. Teitelbaum had received the funds as a legacy from her spouse's estate. Because the funds were received by Ms. Teitelbaum more than a year after her spouse's death, the payment could not be included in her income but should be included in the final return of Ms. Teitelbaum's spouse or in his estate's return.

In reviewing the case, the Court of Appeal agreed that the RCA did not represent an annuity. It found that the testator did not have a property right in the RCA at his death but rather a right of claim against the RCA. This right of claim was transferred to Ms. Teitelbaum by virtue of the particular legacy set out in the will. It did not require any juridical formality to take effect. Rather, the transfer took effect from the date of the testator's death, pursuant to articles 625, 735, and 1808 CCQ, even if payment of the claim did not follow for two years. Because Ms. Teitelbaum received the right of claim in the year of her spouse's death, the Court of Appeal held that she was required by article 430 QTA to include the amount in her income for the year in which she received the payment.

In reviewing the case, the Court of Appeal agreed that the RCA did not represent an annuity. It found that the testator did not have a property right in the RCA at his death but rather a right of claim against the RCA. This right of claim was transferred to Ms. Teitelbaum by virtue of the particular legacy set out in the will. It did not require any juridical formality to take effect. Rather, the transfer took effect from the date of the testator's death, pursuant to articles 625, 735, and 1808 CCQ, even if payment of the claim did not follow for two years.

CHAIR'S MESSAGE

PAMELA CROSS

On behalf of the STEP Canada Board of Directors, I extend my best wishes to all members for a happy and successful year ahead.

In November, the STEP Canada board held its meeting in London, England. The meeting was followed by the STEP Worldwide Branch Chair Assembly and, for those who stayed on, seminars presented by STEP's special interest groups (SIGs). All interested practitioners are welcome to sign up as members of STEP's SIGs at step.org, currently at no cost. Each SIG provides different forums and tools to connect its members with each other, share resources, produce Web events, and deliver presentations to interested branches. The current SIGs represent the following subjects:

- business families
- charities
- contentious trusts and estates
- cross-border estates
- digital assets
- international clients
- mental capacity
- philanthropy advisers

During my term as chair, I will be focusing on enhancing our strong relationship with STEP Worldwide committees and the secretariat staff. We currently hold regular telephone meetings with the Canadian and the STEP Worldwide secretariats, and I thank Canadian STEP council members Nancy Golding (also a STEP Worldwide board member), Bill Fowlis, and Tim Grieve for continuing to facilitate our communication with STEP Worldwide.

With our French-language and civil-law offerings, STEP is enjoying increased recognition among industry practitioners. We are collaborating with aligned Quebec associations, such as the Association de planification fiscale et financière, the Professional Order for Notaries, the Montreal chapter of the Canadian Tax Foundation, and the Montreal-based universities, making many rich connections and encouraging new memberships. My thanks go to Lucie Beauchemin, who has recently become an excellent and passionate STEP ambassador at these Quebec events and conferences.

A record-breaking 348 affiliate and associate members wrote a diploma program examination on November 4th, 2019; 61 of these members were writing their fourth and final exam. Most of the 61 will become TEPs in the new year, and I offer my early congratulations. This examination was the first to take place on our new online digital platform. Kudos to the education department at the national office and the education committee for advancing STEP's educational mandate and greatly reducing our environmental impact.

The STEP Worldwide Professional Development Committee and the STEP Worldwide Board of Directors have approved a revision to the qualifications and membership framework (QMF), which will be introduced in July 2020. The project is called the new STEP diploma. For potential Canadian members, our existing domestic diploma program remains the recommended route to membership. STEP Worldwide expects that most students who are taking the Canada diploma will continue to do so. However, those who would like to deviate from our excellent domestic-focused program, to meet their own or their employer's needs, can also qualify under the QMF. Please inquire at education@step.ca if you would like more details.

In our continued efforts to boost awareness of STEP and the TEP designation, I'm pleased to bring the following Globe and Mail features to your attention. On November 6, 2019, interviews with Deputy Chairs Rachel Blumenfeld and Chris Ireland were featured in a comprehensive article that focused on the importance of estate plans. The article directed readers to seek advisers with experience and credentials. On November 18, 2019, in the lead article of a family business supplement, Cindy Radu and Pam Prior provided a family succession case study, identifying five tips that are essential for businesses considering succession.

The 2020 full-day course tour will begin on January 22. My thanks go to Grace Chow and Ian Pryor for both creating the course and taking it on tour to all our branches and chapters across the country. The course, Taxation of Trusts and Estates, will provide mid- and senior-level practitioners with a foundation in trust and taxation law. Members of the STEP Canada National Programs Committee participated in curriculum reviews and report that the course content is excellent. Registration for the 11 course dates is already showing early signs of selling out in certain cities. Register early because only 45 spots are available in each location.

Planning for the STEP Canada 22nd Annual National Conference is well underway. Keynote speakers for both days have been chosen and secured. The conference chair and deputy chairs, Corina Weigl, Brian Cohen, and Paul Taylor, are supported by a strong and demographically balanced committee. I am sure we can anticipate another superb conference. The sponsorship campaign is well underway, with great success so far. Be sure to save the dates of June 11 and 12, and note the early-bird savings cutoff of February 29!

On behalf of the executive committee, Chris Ireland, Rachel Blumenfeld, Richard Niedermayer, Brian Cohen, and Ruth March, and senior staff, Janis Armstrong and Michael Dodick, I wish to express my sincere appreciation to all of our countless volunteers who tirelessly support STEP's work locally, regionally, nationally, and internationally. Your efforts are ensuring that STEP and its members matter.