STEP Canada
ADVISING FAMILIES ACROSS GENERATIONS

November 3, 2025

Rob Duong
Director General
Tax Legislation Division, Tax Policy Branch
Department of Finance
90 Elgin Street
K1A 0G5

SENT VIA EMAIL TO: Robert.duong@fin.gc.ca

Dear Mr. Duong,

RE: Requesting a Technical Amendment to the Definition of "Testamentary Trust" in Subsection 108(1) of the ITA

The Society for Trust and Estate Practitioners (Canada) (STEP) appreciates this opportunity to respectfully request a technical amendment to the definition of "testamentary trust" in subsection 108(1) of the *Income Tax Act* (Canada) (ITA) as follows:

1. That the 12-month period in paragraph (d) be extended to 36 months, with discretionary extensions available for exceptional circumstances. This aligns with the 36-month "graduated rate estate" regime introduced in 2015.

2. Alternatively, that consideration be given to repealing paragraph (d) of the "testamentary trust" definition since the original purpose of this provision has been largely mitigated by the graduated rate estate regime.

STEP's membership represents a broad cross-section of professional advisors operating in the estate planning and business succession planning fields, and we believe that our comments will assist the Department in evaluating the practical implications of the current legislation and the necessity for amendment.

We would be pleased to discuss our submission with you at your convenience.

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

Yours truly,

Richard Niedermayer, KC, TEP
Chair, STEP Canada

Kenneth Keung, CA, CPA, CPA (CO), CFP, MTAX, LLB, TEP
Chair, STEP Canada Tax Technical Committee

We would like to acknowledge the contributions of the following subcommittee members for their assistance in preparing this submission:

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The Problem: Definitions of "Testamentary Trust" and Loans to the Estate—Subsection 108(1) of the ITA

The definition of "testamentary trust" is contained in subsection 108(1) of the *Income Tax Act* (Canada) (ITA). Meeting this definition is a prerequisite for an estate to elect "graduated rate estate" status, which confers significant tax advantages during the initial 36-month period following the death of an individual. The primary advantages of graduated rate estate status are outlined in Schedule "A" attached hereto.

Prior to the enactment of the graduated rate estate regime in 2015, testamentary trusts were generally entitled to claim graduated personal income tax rates. As a result, multiple trusts created in an individual's will could each separately benefit from graduated personal income tax rates.

Under the original definition of "testamentary trust," it was possible for family members of a deceased individual to provide non-commercial, non-interest-bearing loans to such trusts. This arrangement enabled these testamentary trusts to generate additional investment income and thereby maximize the benefits of graduated income tax rates.

The definition of "testamentary trust" was amended in 2013 to introduce paragraph (d), which specifically addressed such planning. Under the amended rules, an estate or trust forfeits its status as a testamentary trust, and consequently its eligibility for graduated tax rates, if it incurs a debt obligation to a beneficiary or to any person with whom a beneficiary does not deal at arm's length (referred to as a "specified party").

The "testamentary trust" definition contains limited exceptions to this anti-avoidance rule, the most relevant of which for the purposes of this submission is found in subparagraph (d)(iii) of the definition. The carve-out in subparagraph (d)(iii) applies where all three of the following conditions are met:

(A) the debt arose from a payment made by the specified party for or on behalf of the estate/trust;

(B) the debt is repaid with 12 months, or, if written application is made to the Minister within that 12-month period, such longer period as the Minister considers reasonable in the circumstances; and

(C) it is reasonable to conclude that the specified party would have been willing to make the payment for, or on behalf of, the estate/trust if the specified party had been dealing at arm's length with the estate/trust, unless that payment was made within the first 12 months following the individual's death, or, if written application is made to the Minister within that 12-month period, such longer period as the Minister considers reasonable in the circumstances.

The anti-avoidance rule in paragraph (d) was originally introduced without a carve-out for debts repaid within 12 months. A Department of Finance comfort letter dated April 28, 2004 (document no. 2004-04-28) acknowledged the practical reality that family members of a deceased often make payments on behalf of an estate without any expectation or arrangement for arm's-length interest. That letter recommended a legislative amendment to introduce an exception to paragraph (d) for debts of a testamentary trust that are repaid within a 12-month period (or such longer period as the Minister considers reasonable in the circumstances), which ultimately became the carve-out described in (B) above.

The current realities of estate administration, discussed below, frequently require personal representatives and/or beneficiaries to pay expenses that are properly attributable to an estate, such as funeral costs, the estate administration tax (EAT) (also known as probate fees), legal and accounting services, and tax preparation fees. Unfortunately, many estates are often illiquid and therefore unable to repay such expenses within the statutory 12-month period. Indebtedness of

this nature should not be considered abusive and, in the STEP Technical Committee's opinion, should not be subject to the anti-avoidance rule in paragraph (d). While the legislation permits a written application to the Minister for an extension of the repayment period, this process is administratively burdensome, discretionary, and often inaccessible to personal representatives who lack sophisticated tax counsel. Moreover, the timing of repayment is frequently uncertain, particularly where the estate holds illiquid assets such as real property or shares in a private corporation.

The 12-month repayment requirement fails to reflect practical timelines and imposes undue risk on personal representatives and beneficiaries who may have limited ability to accelerate repayment. As demonstrated below, given current realities, estate administration may take much longer than 12 months.

If an estate loses testamentary trust status under the anti-avoidance rule in paragraph (d), the estate could face significant tax consequences, such as income being taxed entirely at the top marginal rate, alternative minimum tax that may be unrecoverable to the estate, and additional tax burdens in respect of stock option benefits, pensions, and death benefits. Furthermore, the estate could be subject to double taxation without the ability to carry back capital losses realized in the estate under subsection 164(6) of the ITA, such as where an estate's stock portfolio values decline post mortem or on the winding up of a private corporation. These outcomes are unduly punitive.

Even where an estate satisfies clause (d)(iii)(B) of the "testamentary trust" definition by repaying an indebtedness to a specified party within 12 months, it must also satisfy clause (d)(iii)(C) if the debt arose more than 12 months after death. This latter condition requires that the specified party's payment and resulting indebtedness be made on terms that an arm's-length party would reasonably accept. As illustrated below, most estates cannot be wound up within 12 months of death, and ongoing expenses often necessitate payments by family members. In many cases, the estate would not qualify for arm's-length financing, and even if it did, such financing would likely come with high interest rates and onerous repayment terms. It is unrealistic to expect family members to impose such terms on an estate for payments made more than 12 months after death. As a result, the current wording of clause (d)(iii)(C) effectively disqualifies many estates from testamentary trust status—even where debts are repaid within 12 months of having been incurred.

Current Realities of Estate Administration

In the past, it was commonly expected that estates could be administered and wound up within one year of the testator's death, known as the "personal representative's year." There are many reasons why a 12-month period is no longer a practical timeline for estate administration. To better understand the reasons why this is the case, the STEP Technical Committee believes that it would be helpful to review the estate administration process in its entirety. The steps and timelines noted below are based on the experience of members of the STEP Technical Committee and are provided for illustrative purposes only. While actual steps and timelines may vary for any particular estate, the timeline below demonstrates that even for an estate with no complications, it still typically takes more than 20 months to administer.

1. Preliminary Steps

Estate administration starts on the death of the taxpayer; in most cases, the process is governed by the will of the deceased and/or provincial intestacy law. Commonly, a family member close to the deceased is either appointed as executor of the estate by will, or granted that authority by court order in the case of intestacy. (For ease of reference, that role, howsoever assumed, will be referred to in the balance of this submission as the "personal representative.") The personal representative must deal not only with the emotional grief of losing a loved one, but also with the complexities of administering an estate that are common in today's legal landscape.

One of the first duties that a personal representative must carry out is to locate the original will document (if any) and obtain a verification/certification of the appointment as personal

representative. This duty may sound straightforward, but often the personal representative has no idea where or how to start the verification/certification process. Usually, the deceased's professional advisors are contacted to help with the process. But if the deceased did not have professional advisors, or if the personal representative does not know who these advisors were, delays may arise. It is reasonable to expect that these preliminary steps can take anywhere from one to three months.

2. Gathering Information and Assets

At this step of the estate administration process, the personal representative identifies and locates all assets of the deceased, including bank accounts, investments, real estate, vehicles, and personal belongings. The personal representative also gathers information about the deceased's debts, liabilities, and taxes. Even at this early stage of estate administration, it is common for administrative delays to arise. For example, it can take four to six months to comply with the policies of financial institutions for verifying identities so that all bank and investment accounts of the deceased can be located and their balances ascertained; this process is often made even more complicated if the deceased had multiple accounts at multiple institutions.

3. Notifying Beneficiaries and Creditors

The next step of the estate administration process tends to involve the personal representative ascertaining and informing all beneficiaries named in the will (or next of kin if there are predeceased named beneficiaries, or there is no will) about the deceased's passing and the estate's status. Notice is also given to creditors to allow them to make claims against the estate. It is reasonable to expect that this step can take up to one to two months.

4. Probate

Probate is a court process that involves the personal representative providing a court with a listing of all assets of a deceased, including the fair market value of the assets held by, and certain liabilities owed by, the deceased at the time of death. The listing is then approved and certified by the court. Not all estates require probate certification, so legal guidance will be needed to determine whether this step is necessary.

Probate can take anywhere from one to four months depending on the jurisdiction. For probate purposes, the fair market values of the estate assets need to be provided to the court, and gathering this information may add to the time needed to apply for probate. Examples of the information that must be gathered include real estate appraisals and company valuations. In Alberta, once an application is submitted to court for probate, it can take up to four months for the application to be approved, and that period can be extended if complexities arise. We also understand that Ontario has slow probate processing times due to the volume of estates that the courts are dealing with in that province.

Where an estate owns an illiquid asset such as land, it has an obligation to pay the EAT. The estate may seek an order from the court to defer the payment of the EAT until the illiquid asset is sold. We understand that the courts, as a condition of granting the deferral, have required a personal undertaking from the estate lawyer to pay the EAT upon the sale of land. Often, however, the estate lawyer would not wish to provide this personal undertaking. As a result, the beneficiary typically pays the EAT to obtain the certificate and to enable the estate to sell the illiquid asset.

5. Post Mortem Tax Planning

As the estate administration process proceeds, it is often recommended that a personal representative hire professional advisors (accountants and lawyers) to assist with tax issues arising from the deceased's assets and affairs, and to determine whether a post mortem tax plan is appropriate to avoid double taxation. For example, if the deceased owned shares of a private

corporation, it will take time to analyze whether "pipeline" planning or "loss carryback" planning is advisable. At a minimum, for the advisors to conduct an appropriate analysis, the personal representative will need to review a host of legal documents and arrange for the preparation of financial statements, corporate tax returns, asset valuations, and calculations to determine tax balances, such as adjusted cost base and paid-up capital amounts. Assets such as real estate, collectibles, businesses, and private company shares may not have readily determinable values, so it may be necessary to engage professional valuators to assist with the asset valuation process, which increases the time needed for estate administration. If any post mortem tax planning is pursued, it is reasonable to expect this step to take four to six months or, where the deceased has complicated assets, often significantly longer.

6. Settling Debts and Taxes

At this stage of the estate administration process, the personal representative pays all outstanding debts, including funeral expenses, outstanding taxes (income tax, probate tax, etc.), and any other liabilities. This often requires preparing bookkeeping for the estate, as well as preparation and filing of the terminal T1 return and estate T3 return(s). It is reasonable to assume that this step can take anywhere from two to three months even when no tax planning is pursued.

In most cases, these debts and taxes cannot be paid using the funds in the estate but must be paid using loans from specified parties, because it may not be prudent to use any of the estate cash until after the final accounting in Step 8 below has been completed. The use of funds from specified parties is particularly common in the cases of asset-rich and cash-poor estates involving large real estate holdings or shares of private companies.

7. Distributing Assets

Once all debts and taxes of the estate are settled, the next step in the estate administration process is for the personal representative to distribute the remaining assets to the beneficiaries according to the terms of the will (or according to the intestacy rules of the relevant jurisdiction). The distribution process may involve transferring property, distributing funds from bank accounts, or selling assets to facilitate distributions. It is reasonable to expect that this step can take up to one month or longer.

8. Final Accounting

The last step in the estate administration process involves the personal representative preparing a final accounting of all financial transactions related to the estate. This accounting is often provided to beneficiaries to demonstrate how the estate was administered. It is reasonable to expect that this step can take up to one month or longer.

Complications

This summary of the steps involved in administering an estate in Canada does not contemplate other common issues that may cause a delay, including will interpretation, estate litigation, family law issues, dealing with minor beneficiaries and associated government agencies (such as the Public Guardian and Trustee), intestacy, and cross-border assets. It is not prudent or recommended for the estate to repay amounts owed to non-arm's-length parties until all of the creditors and beneficiaries of the estate have been identified and the amounts of their entitlement have been determined. Therefore, any one of these issues that delay administration of the estate will jeopardize the ability to have specified party debts repaid within 12 months. These issues will also make it more likely that a specified party will be making payments on behalf of the estate more than 12 months after the death of the testator.

In the 2019-2020 reporting period, 20% of the family law caseload in Canada, as reported by Statistics Canada, involved estate matters and other family law cases, such as adoptions. This

means that 20% of the cases handled within the family law system were not related to divorce, custody, access, or support, but rather were focused on issues like estate disputes.[1] As practitioners, we have noticed that estates are becoming more litigious, likely because families are inheriting more wealth, in particular as a result of increased real estate values.

Statutory Waiting Periods and Clearance Certificates

Some statutory waiting periods that must be observed can delay estate administration. For example, in British Columbia, there is a 210-day waiting period before a grant of probate becomes effective, and only after the end of this waiting period can assets be distributed. In Saskatchewan, after letters probate or administration are issued, there is a six-month waiting period for dependant or spousal claims before the estate can be distributed. This delay allows dependants and spouses to apply for relief. Personal representatives may be personally liable if they ignore this waiting period. Dependants and spouses may, however, provide written consent for an earlier distribution, which is common in practice. In Alberta, while there is no statutory waiting period, personal representatives take on personal liability if they administer the estate and a claim is brought within six months. There are similar provisions in every jurisdiction across Canada. Moreover, certain provinces have legislation dealing with posthumously conceived children. Under these regimes, if a notice of intention to use reproductive material of the deceased is filed, the estate may have to remain open for up to three years after the taxpayer's death.

The typical time for obtaining a clearance certificate from the Canada Revenue Agency confirming that the estate has paid all amounts, including income tax and GST/HST, interest, and penalties, has increased over the years. Typical cases appear to take four to six months. While not all estates request clearance certificates for tax matters, this additional step is appropriate in some cases and will lengthen the time needed to complete final distributions and specified party loan repayments, or require a specified party to make payments on behalf of the estate more than 12 months after the testator's death.

Date of Death and Filing Deadlines

Under the ITA, if a testator dies between January 1 and April 30 in a year, the personal representative has until April 30 of the following year to file the terminal tax return. This case is common because most tax-filing information needed to complete the terminal tax return is not available until the following year. So, even within the rules of the ITA itself, a 12-month relieving provision does not allow sufficient time for proper estate administration.

Previous Technical Amendments

CRA document no. 2004-04-28, issued in 2004, outlines the concession and reasoning previously agreed to by the Director, Tax Legislation Division, Tax Policy Branch that led to the exception for debts and loans to be repaid within 12 months. We are making this submission because, in our experience, the original 12-month exception is no longer workable in the current context of estate administration. In many of the cases that we are dealing with, estates cannot be wound up within 12 months. Given all of the factors raised in this submission that bear on estate administration, it is our view that 36 months is a more reasonable time frame because, at present, without any complications at all, estates take an average of 20 months to administer.

We also refer to the recent Department of Finance concession regarding the proposed amendment to subsection 164(6) of the ITA, which extends the loss carryback period from one year to three

[1] See Lyndsay Ciavaglia Burns, "Profile of Family Law Cases in Canada, 2019/2020," *Juristat*, June 28, 2021 (https://www150.statcan.gc.ca/n1/pub/85-002-x/2021001/article/00011-eng.htm).

years on a similar basis, namely, that 12 months is not sufficient time for estate administration. See our letter to the Department of Finance dated June 21, 2024.[2]

Specific Request for Technical Amendment

In conclusion, as outlined herein, we are requesting the following technical amendments:

1. The 12-month period in paragraph (d) of the definition of "testamentary trust" in subsection 108(1) of the ITA should be expanded to 36 months,

    a. to recognize the current complexities of estate administration, and

    b. to be consistent with the 36-month period applicable under the graduated rate estate regime that was introduced in 2015.

    As is provided under current legislation, personal representatives should be able to apply to the Minister for a discretionary extension over the 36-month period if estate disputes or other uncontrollable issues arise, to allow for longer periods for the repayment of loan/debt from specified individuals and specified parties to make payments on behalf of the estate after the 36-month period.

2. In the alternative, the Department of Finance should repeal paragraph (d) of the definition of "testamentary trust" in subsection 108(1) of the ITA because the anti-avoidance rules of the provision, with the enactment of the graduated rate estate regime in the ITA, no longer serve their original purpose.

[2] https://step.ca/downloads/memberservices/TTC%202024-06-21%20Submission%20-%20Requesting%20Technical%20Amendment%20to%20ITA%20Subsection%20164(6).pdf.

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SCHEDULE "A"

Tax benefits that are eliminated if an estate loses testamentary trust status, and therefore graduated rate estate status

- Preservation of access to the graduated personal income tax rates for up to 36 months.
- Flexibility to adopt a non-calendar year-end to access the benefits of graduated rate estate status for the full 36 months after death.
- Potential exemption from the T3 filing obligation as a "listed trust" under paragraph 150(1.2)(j) of the ITA.
- The ability to flow through pension benefits under subsection 104(27) of the ITA to a beneficiary who would otherwise be ineligible for the pension credit.
- The ability to flow through a death benefit to a beneficiary under subsection 104(28) of the ITA so that the first $10,000 remains non-taxable.
- Access to the 50% deduction under paragraph 110(1)(d) of the ITA in respect of stock option benefits deemed to arise on death under paragraph 7(1)(e) of the ITA.
- Relief under subsection 164(6.1) of the ITA where the actual stock option benefit realized by a deceased employee is less than the deemed benefit reported on the deceased's final return.
- Discretion in allocating donation tax credits either to the deceased's terminal return or to the estate's tax payable, to ensure that the benefit of the credits is not lost where the estate has insufficient taxable income.
- The ability to elect under subsection 164(6) of the ITA to carry back capital and terminal losses realized by the estate to offset gains and income reported on the deceased's final return.
- Exemption from the alternative minimum tax pursuant to paragraph 127.55(f) of the ITA.
- Relief from the stop-loss rule in subsection 112(3.2) of the ITA, up to 50% of the date of death capital gain, which is crucial for the tax integration for life insurance proceeds received by a private corporation.
- The ability to trigger a capital loss on positive adjusted cost base of a partnership interest under subsection 40(3.12) of the ITA and to carry the loss back against a prior capital gain under subsection 40(3.1) of the ITA.
- Exemption from Part XII.2 tax pursuant to subsection 210(2) of the ITA where one of the beneficiaries is a non-resident.
- Relief under the proposed amendment to paragraph 212.1(6)(b) of the ITA, facilitating post mortem pipeline planning in estates with a non-resident beneficiary.
- Exemption from the requirement to remit instalments pursuant to subsection 156.1(2) of the ITA (noting the Canada Revenue Agency's current administrative practice of not assessing penalties or interest where an estate or trust fails to make instalments).
- The ability to file a notice of objection up to one year after the filing-due date for the year, pursuant to paragraph 165(1)(a) of the ITA.
- The ability to access the taxpayer relief provision under subsection 152(4.2).