THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

The Joint Committee on Taxation of
The Canadian Bar Association
and
Chartered Professional Accountants of Canada

Chartered Professional Accountants of Canada, 277 Wellington St. W., Toronto Ontario, M5V3H2
The Canadian Bar Association, 500-865 Carling Avenue Ottawa, Ontario K1S 5S8

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Mr. Brian Ernewein
General Director, Tax Legislation Division
Tax Policy Branch
Department of Finance
L'Esplanade, East Tower
140 O'Connor Street, 17th Floor
Ottawa, ON K1A 0G5

Mr. Ernewein:

Enclosed is our submission on the draft legislative proposal that was released by the Department of Finance on June 3, 2013.

Several members of the Joint Committee and others participated in discussions concerning our submission and contributed to its preparation, in particular:

Bruce Ball (BDO Canada LLP)
Dale Franko (Moodys Gartner Tax Law LLP)
Larry Frostiak (Frostiak & Leslie Chartered Accountants Inc.)
Nancy Gomes (KPMG LLP)
Lisa Handfield (Moodys Gartner Tax Law LLP)
Riaz Mohamed (Moodys Gartner Tax Law LLP)
Kim G C Moody (Moodys Gartner Tax Law LLP)
Joel Nitikman (Dentons Canada LLP)
Karen Yull (Grant Thornton LLP)

We trust that you will find our comments helpful and would be pleased to discuss them with you at your convenience.

Yours very truly,

Penny Woolford
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Mitchell Sherman
Chair, Taxation Section
Canadian Bar Association

The Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada is pleased to provide you with this written submission on certain aspects of the draft legislative proposal entitled Consultation on Eliminating Graduated Rate Taxation of Trusts and Certain Estates (the "Proposal") dated June 3, 2013.

Unless otherwise indicated, references to subsections, paragraphs, etc., are to provisions of the *Income Tax Act* (Canada) (the "Act")[1].

A. SUMMARY

The Proposal suggests taxing all testamentary trusts at the top marginal rate and taxing estates at that rate after the first 36 months of administration. As with *inter vivos* trusts, a deduction will be provided for income payable to beneficiaries of an estate or a testamentary trust.

The Proposal's main objective appears to be to mitigate the perceived abuse of creating multiple testamentary trusts upon death. Under current legislation, a taxpayer is able to create multiple testamentary trusts, each of which will have access to its own set of graduated rates provided that the income of the trusts will not accrue to the same beneficiary or group of beneficiaries. Absent the testamentary trust, income generated by the assets of a deceased individual would ordinarily be subject to tax in the beneficiaries' hands. The Proposal states this asymmetrical outcome is not in accordance with tax neutrality.

Recommendation

As you will note below, the Committee strongly believes that the status quo should be maintained. We fail to see any compelling policy reasons for a change. Such a change was considered by Parliament in 1972 and specifically rejected; nothing has changed since then. However, should you disagree, we have outlined below an alternative position with some specific amendments to the Proposal.

B. STATUS QUO

1. The Estate and Personal Representative

As a starting point, it is necessary to briefly define some key concepts. Each province has legislation that governs the administration of estates. While the *Estates Administration Act* (Ontario)[2] does not define the term "estate", section 2 of this Act states that:

> …all real and personal property that is vested in a person without a right in any other person to take by survivorship, on the person's death, whether testate or intestate and despite any testamentary disposition, devolves to and becomes vested in his or her personal representative from time to time as trustee for the persons by law beneficially entitled thereto, and, subject to the payment of the person's debts and so far as such property is not disposed of by deed, will, contract or other effectual disposition, it shall be administered, dealt with and distributed as if it were personal property not so disposed of.

A more succinct definition is provided by the *Wills, Estates and Succession Act* (British Columbia)[3] which defines an "estate" as "the property of a deceased person". The *Wills and Succession Act* (Alberta)[4] does not define an estate. Accordingly, an estate is simply all of the deceased's property that the personal representative must deal with.

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[1] The *Income Tax Act*, RSC 1985, c.1 (5th Supp.), as amended and proposed to be amended, and including the regulations promulgated thereunder (the "Act"). Unless otherwise stated, statutory references in this memorandum are to the Act. No assurance can be given that proposed amendments to the Act will be enacted in the form proposed or at all.
[2] R.S.O. 1990, c. E-22.
[3] S.B.C. 2009, c. 13. This Act comes into force on March 31, 2014.
[4] S.A. 2010, c. W-12.2.

The personal representative of an estate is defined generally to mean an executor or an administrator of the estate of a deceased individual.[5] Specifically, an executor is a person appointed by will whereas an administrator is appointed by the court. The task of the personal representative is to "gather in the assets of the deceased, to discharge funeral and testamentary expenses, and debts, and to distribute the remaining assets among the persons entitled".[6] The role of the personal representative is similar to that of a trustee as he/she "steps into the shoes of the deceased [and] title in both personal and real property vests" in him/her but the role of the personal representative is more limited in that it is comprised of a single task.[7] While the Act references subsection 104(1), it does not directly define an estate or a personal representative.

2. Testamentary and *Inter Vivos* Trusts

A trust can be described by its function, which is "to serve as a conduit pipe and to hold its corpus and the income derived therefrom for the benefit of others".[8] A trust is the relationship between a person, the trustee, who legally owns an asset for the benefit of another person, the beneficiary. Both testamentary and *inter vivos* trusts are legal relationships, as opposed to legal entities. At common law, a testamentary trust is one that is established by the terms of a will and arises on that individual's death. Assets may become part of a testamentary trust only after the executor(s) assent to the settlement of the trust which may occur only after the personal representative(s) has been satisfied that the remaining assets are sufficient to pay any remaining debts and liabilities.[9] An *inter vivos* trust is one that is created by a person to take effect in his/her own lifetime.

Subsection 248(1) of the Act defines a "trust" to have the meaning assigned by subsection 104(1) and where the context requires, includes an estate. Subsection 104(1) of the Act does not actually define a trust, but provides that a reference to a trustincludes a reference to the trustee or executor, unless the context otherwise requires. Subsection 104(1) of the Act excludes relationships of agency, commonly referred to as bare trusts.

Subsection 248(1) of the Act defines a "testamentary trust" to have the meaning assigned by subsection 108(1), which provides that a testamentary trust is a "trust that arose on and as a consequence of the death of an individual". Due to the use of the term "trust" and its definition in subsection 104(1) of the Act, a testamentary trust includes an estate.[10] A testamentary trust excludes trusts where any property was contributed to them otherwise than by an individual on or after the individual's death and as a consequence thereof.[11] A trust is not a testamentary trust if, for taxation years ending after December 20, 2002, the trust incurs a debt or other obligation to pay an amount to, or guaranteed by, a beneficiary or other person or partnership with whom any beneficiary of the trust does not deal at arm's length.[12] Subsection 248(1) of the Act defines an "*inter vivos* trust" to have the meaning assigned by subsection 108(1), simply "a trust other than a testamentary trust".

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[5] See paragraph 1(h) of the *Wills and Succession Act* (Alberta) and section 1 of the *Estates Administration Act* (Ontario).
[6] *Waters' Law of Trusts in Canada* (4th Ed.) by Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith (Toronto, Canada: Carswell), 2012, at page 47.
[7] Ibid. at page 48.
[8] *Income Taxation of Inter Vivos Trusts* by Marshall A. Cohen (Toronto, Canada: Canadian Tax Foundation), 1964, at page 2.
[9] *The Forgotten Law of Assent* by Joel Nitikman, Trusts & Trustees, Vol. 18, No. 7 (2012), at page 672.
[10] The pre-December 20, 2002 definition of a "testamentary trust" explicitly referred to an estate.
[11] Paragraphs 108(1)(b) and (c) of the Act.
[12] Paragraph 108(1)(d) of the Act.

3. Purpose of a Testamentary Trust

Testamentary trusts are used to benefit children, family members and others in a wide variety of circumstances. These trusts are designed to separate the legal ownership of assets from their beneficial enjoyment in circumstances where it is not desirable for the beneficiary to have control of the assets directly. Such circumstances include the following, which are detailed in the submission of the Wills and Estates Section of the Canadian Bar Association:

a) young adults who have reached the age of majority but may not be mature enough to effectively manage the assets;[13]

b) mentally or physically disabled individuals who lack capacity to manage funds or the assets directly;

c) individuals suffering from addictions where it is not desirable to give funds or assets directly to such individuals for fear that it will result in more harm than good;

d) spendthrift individuals who are not able to manage money adequately;

e) elderly individuals, who because of age, are vulnerable to financial abuse; and

f) infants, minors and the unborn.

We believe that a settlor may have significant motivation, absent any tax considerations, to ensure that the bequested assets, and income derived therefrom, are administered by a trustee.

4. History of the Taxation of Trusts

Prior to the enactment of the modern version of the Act in 1972, estates, testamentary trusts and *inter vivos* trusts were considered to be "individuals" who were taxed at graduated rates without access to personal exemptions. Estates, testamentary trusts and *inter vivos* trusts were entitled to distribute their annual income to their beneficiaries, deducting the same from the trust's income, and this income would be taxed in the hands of the beneficiaries at their marginal rates.

The 1966 Royal Commission on Taxation (commonly referred to as the "Carter Commission") analyzed the proposed treatment of trusts in Chapter 21 of their *Report of the Royal Commission on Taxation* stating that the prevention of the deferment of tax through trusts was a prime objective of the Commission. Specifically, the Carter Commission expressed concerns that some *inter vivos* trusts were taking undue advantage of their right to pay tax at graduated rates by accumulating excessive amounts of income rather than distributing the income to beneficiaries. However, the Carter Commission did not discuss how much accumulation was excessive. The Carter Commission recommended that *inter vivos* trusts be taxed at a flat rate, with the beneficiaries being entitled to a credit for tax paid by the trust when it distributed the income.

The Carter Commission made no recommendations regarding estates and testamentary trusts. One must assume that the Commission did not leave out estates and testamentary trusts inadvertently. One possibility is that the Carter Commission did not perceive that estates and testamentary trusts were taking undue advantage of accumulations, in contrast to *inter vivos* trusts. It is also possible that the Commission viewed estates and testamentary trusts differently as they arise on death which is not a planned event.

[13] This is especially important in jurisdictions like Alberta and Manitoba which have legislatively abolished the rule in *Saunders* v. *Vautier* and thus do not allow a beneficiary who has reached the age of majority to automatically terminate the trust.

One of the basic propositions of the Carter Commission was that there should be, so far as possible, integration of trust and personal incomes so that the ultimate tax liability will depend on the beneficiaries' ability to pay.[14] To implement this proposition, the Carter Commission stated that where income is distributable currently, the beneficiary may elect to pay tax at his/her marginal rate, meaning there would not be taxation at the trust level.[15] Where the income is accumulated in the trust, the Carter Commission stated that if the prospective beneficiary could be identified with reasonable probability, the beneficiary may elect that his/her marginal rate will be the initial rate.[16] The latter provision was described as "sensible" since it "prevent[s] the government from taking more than it will be ultimately entitled to receive".[17]

In response to the Carter Commission, the White Paper on Taxation, entitled *Proposals for Tax Reform,* was issued in 1969 by the federal government. Section 5.55 of the White Paper outlined the general system for the taxation of estates, testamentary trusts and *inter vivos* trusts as set out above. Section 5.56 of the White Paper suggested that some *inter vivos* trusts should be deemed to be corporations for tax purposes.

Section 5.57 of the White Paper discussed the accumulation problem identified by the Carter Commission in respect of *inter vivos* trusts and, without citing proof, stated that the number of accumulating trusts had recently increased. Further, the White Paper stated that an accumulating *inter vivos* trust may pay less tax than the beneficiary would pay if the income was distributed. However, the reverse may also be true. The White Paper proposed that all trusts (estates, testamentary trusts and *inter vivos* trusts) be taxed at a flat rate with a special relieving provision that would reduce the flat rate for estates and testamentary trusts that would suffer hardship by being taxed at the flat rate, provided no one other than the deceased transferred property to the estate or testamentary trust.

In 1970, the White Paper was referred to the Standing Committee on Finance, Trade and Economic Affairs in the House of Commons and to the Standing Committee on Banking, Trade and Commerce in the Senate. The Senate Banking Committee reported to the Senate that it rejected the proposal in section 5.57 of the White Paper.[18] The House of Commons did not make any recommendation on the trust proposals in the White Paper as various groups were discussing such proposals directly with the Department of Finance.[19]

The 1972 revisions to the Act preserved the status quo for *inter vivos* trusts created prior to June 18, 1971. Subsection 122(2) of that Act imports tax on new *inter vivos* trusts and older *inter vivos* trusts that do not meet certain conditions at a flat rate of 50.7 percent. The taxation of testamentary trusts was not altered by these revisions. Consequently, it can be concluded that Parliament specifically decided that it was appropriate to treat testamentary trusts differently from *inter vivos* trusts.

Prior to the 1995 Budget, the preferred beneficiary election (the "PBE") was generally available for a beneficiary that was a settlor of the trust, a spouse or former spouse of the settlor, child or a grandchild of the settlor. Due to perceived abuses such as income accumulation and income splitting, the legislation was amended. The perceived abuses were mitigated by revising the legislation so as to be accessible only by disabled beneficiaries.

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[14] *Gifts, Inheritances and Trusts and the Carter Report* by William M. Carlyle (Don Mills, Canada: CCH Canadian Limited), 1967, at page 10.
[15] Ibid. at page 11.
[16] Ibid.
[17] Ibid.
[18] *Canada, Senate Standing Committee on Banking, Trade and Commerce, Report on the White Paper Proposals for Tax Reform* presented to the Senate of Canada (Ottawa, Canada: Queen's Printer), 1970, at page 74.
[19] *Canada, House of Commons, Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs Respecting the White Paper on Tax Reform* (Ottawa, Canada: Queen's Printer), 1970, at page 80.

5. Current Taxation of Trusts

Under the Act, and notwithstanding that trusts are a legal relationship, subsection 104(2) of the Act deems a trust (which includes an estate) to be an individual and therefore a separate taxpayer. Although trusts are deemed to be individuals under the Act, subsection 122(1.1) of the Act states that trusts are not entitled to personal credits in section 118 of the Act. Subsection 117(2) of the Act provides that individuals are taxed at progressive marginal tax rates;[20] however, subsection 122(1) of the Act overrides subjecting *inter vivos* trusts to the highest marginal tax rate on all income.

If the income of a trust is payable[21] to a beneficiary, then the trust may deduct such income pursuant to subsection 104(6) of the Act. Subsection 104(13) of the Act taxes the income deducted by the trust in the hands of the beneficiary. Alternatively, a trust may elect, pursuant to subsection 104(13.1) of the Act, to have income taxed in the trust regardless of whether the amount is payable to a beneficiary. Subsection 104(18) of the Act provides that certain income of the trust may be deemed to be payable to an individual who did not attain 21 years of age and such income may be deducted from the income of the trust under subsection 104(6) of the Act.

The PBE allows a person who qualifies as a "preferred beneficiary",[22] defined in subsection 108(1) of the Act, to make a joint election with the trust in respect of the beneficiary's allocable amount and the trust's "accumulating amount" (defined in subsection 108(1) of the Act). As such, the amount elected is included in the beneficiary's income pursuant to subsection 104(14) of the Act even if such amount is not payable to him/her and regardless of whether someone other than the beneficiary actually receives the amount. The amount elected is deducted from the trust's income under subsection 104(12) of the Act.

Testamentary trusts (including estates) are not required to pay tax by instalments pursuant to paragraph 104(23)(e) of the Act, but rather must pay tax within 90 days from the end of their taxation year.

Subsection 104(2) of the Act allows the Minister to designate several trusts to be an individual whose property is the property of all the trusts and whose income is the income of all the trusts in situations where substantially all of the property of these trusts was received from one person and the trusts are drafted so that the income thereof accrues to the same beneficiary or group of beneficiaries.

6. Fairness or Equity

Fairness or equity is a tax policy objective. Horizontal equity requires taxpayers in similar circumstances to pay the same level of tax. Vertical equity requires appropriate differences among taxpayers in different economic circumstances. While the concepts of fairness and equity have intuitive appeal, it does "not necessarily inform us about what makes good tax policy nor [does it] allow us to characterize decisions that deviate from them as being bad tax policy".[23]

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[20] Subsection 127.53(2) provides for one exemption of $40,000 from the alternative minimum tax to be shared by testamentary trusts that are related to a single deceased individual.

[21] Pursuant to subsection 104(24) an amount is deemed not to have become payable to a beneficiary in a taxation year unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment.

[22] A preferred beneficiary is an individual who is eligible for the disability tax credit in subsection 118.3(1) or who is at least 18 years old and dependent on another individual because of physical or mental infirmity and earns a minimal amount of income. In addition, the preferred beneficiary must be the settlor of the trust or a spouse/common-law partner, child, grandchild or great grandchild of the settlor of the trust.

[23] *Tax Policy in Canada* by Heather Kerr, Ken McKenzie and Jack Mintz (Toronto, Canada: Canadian Tax Foundation), 2012.

7. Neutrality and Integration

Tax neutrality is another key tax policy objective. Neutrality is the idea that a taxpayer's decision to devote capital and/or labour to a particular economic endeavor should not be affected by the relative tax treatment of competing opportunities or tax incentives, but rather made on its economic merits. Neutrality involves the principle of integration whereby a taxpayer is put in the same economic position regardless of the vehicle used to earn income. Integration functions reasonably well between corporations and individuals in Canada.

The Proposal to tax all income accumulated in a testamentary trust at the highest marginal rate will, if implemented, discourage effective estate planning in the circumstances outlined above. It will defeat the use of the trust as a vehicle to provide for those individuals listed above and force families to "hurry" property through the estate. Individuals drafting their wills are less likely to give a trustee discretion over payments of income to beneficiaries and the trustee who has been given discretion will be reluctant to accumulate income in the trust because of the punitive tax rate on accumulations, even though it may otherwise be in the beneficiaries' best interests for the trustee to accumulate income.

Waters' Law of Trusts in Canada[24] explains this concept succinctly:

> It is difficult to resist the conclusion that the "hurrying along" of the property through the trust, so that it can be taxed in each beneficiary's hands at his marginal rate of tax, should be seriously questioned. In its place, it would seem to be preferable to have a more precisely integrated tax system between the trust and the beneficiary. The trust would pay tax at the same rates as any individual person on any income or capital gain that, given the terms of the trust, is not transferred to a beneficiary during the tax year, and a credit for tax paid would be awarded to the ultimate beneficiary transferee. It is true that there are counter considerations; there is the relative accounting complexity of an integrated system as compared with the simplicity of the current approach, and the necessity of the retention of annual trust records going back over possibly a significant number of years, together with the tax records of the beneficiary in question over the same period. These are formidable concerns, but nevertheless the idea of integration is not by any means new (indeed it is included in the present Act, albeit imperfectly), and it may prove as valuable to the realization of the potential of the trust as it has already to the private corporation.

However *Waters' Law of Trusts in Canada*[25] notes, neutralizing the use of the trust as a tax avoidance measure can be accomplished in one of two ways:

a) by "hurrying" property through the trust to be taxed in the hands of the beneficiary, or

b) by integrating the taxation of the trust and the taxation of the beneficiary.

The Committee believes that achieving integration between trusts and their beneficiaries is critical to ensuring that assets and income are not hurried through the trust or estate. There are examples throughout the Act of integration between a trust, notably an estate, and an individual. Subsection 164(6) of the Act allows a capital loss realized in the first year of the estate to be carried back to apply against capital gains arising in the deceased's terminal return. It should be noted that when this provision was devised there was a one-year carryback available to capital losses; however, capital losses are now subject to a three-year carryback. While subsection 164(6) of the Act may have been designed as a loss relieving provision, it accomplishes integration between an estate and the deceased taxpayer whereby the estate is put in the same position that the individual would have been but for the intervening death.

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[24] Supra at note 5 on page 639 in the context of current rules for taxing *inter vivos* trusts.

[25] Supra at note 5 on page 637.

Similarly, subsection 118.1(5) of the Act deems charitable donations made by a deceased individual in his/her will, regardless of the taxation year in which the gift is actually made, to have been made immediately before death thus putting the estate in the same position that the individual would have been but for the intervening death.

Recommendation

The Committee believes that it would be appropriate to maintain the current legislation without the proposed amendments. There are no documented statistics to support the purported increase in the use of testamentary trusts for tax planning from 1972 to present, and thus no compelling reason for a change in the taxation legislation governing trusts.

Concerns regarding the use of multiple testamentary trusts should be addressed through existing legislative provisions, namely subsection 104(2) of the Act. We do not believe it is appropriate to enact further legislative provisions to address a concern that is addressed by the current legislative provisions.

Alternative Recommendation

If the status quo is not accepted, the Committee believes it would be appropriate to implement a measure that amends the PBE in the current legislation. The purpose of this amended PBE would be to allow a testamentary trust to access a preferred beneficiary's graduated rates without creating an enforceable liability to the beneficiary.

Our alternative recommendation is twofold:

1) the PBE be amended[26] to allow:

    a. a trust created for the benefit of one specifically identified beneficiary, and

    b. income and capital of the trust can be allocated only to that specifically identified beneficiary; and

2) the preferred beneficiary definition (specifically with respect to testamentary trusts) should be revised to include any individual beneficiary specifically identified by the settlor.[27]

The Committee believes this alternative recommendation will eliminate the perceived abuses noted in the Proposal while respecting the intention of a settlor by ensuring that any decisions made by a trustee are not motivated by tax considerations.

Under our alternative recommendation, the income accumulated in the testamentary trust will be taxed using the specifically identified beneficiary's graduated tax rates. As the income and capital will be restricted to a single individual beneficiary, the ability to access multiple sets of graduated rates would be eliminated.

Furthermore, our alternative recommendation will promote neutrality. Under the Proposal, integration will only be achieved if the funds accumulated in the trust are "hurried up" and allocated to the beneficiary(ies) as they are accumulated. In contrast, our alternative recommendation will facilitate an equal tax burden regardless of whether the asset was directly bequeathed to the beneficiary or held for the benefit of the beneficiary in a testamentary trust. As noted above, there are significant non-tax reasons for the use of testamentary trusts.

[26] This would involve an amendment to subsection 104(14) of the Act.
[27] This would involve an amendment to subsection 108(1) of the Act.

C. 36-MONTH ESTATE ADMINISTRATION PERIOD

The Proposal states that taxation at the top marginal rate is to apply to "flat top-rate estates" after a reasonable period of administration. Specifically, the Proposal explains that a deceased individual's estate would be converted from an estate that is taxed at marginal rates into an estate that is taxed at the top marginal tax rate (i.e. "flat top-rate estates") "starting immediately after the 36-month period that follows the individual's death". At the time of conversion the estate would be subject to a deemed taxation year-end. Thus, under the Proposal, estates would be taxed at graduated rates only for the first 36-months of the estate's administration. This measure would apply to existing and new arrangements for the 2016 and subsequent taxation years.

1. Estates are Not Necessarily Wealth Accumulation Vehicles

The Proposal states that the current taxation of *inter vivos* trusts constrains the use of this type of trust for tax planning. Further, the Proposal notes that there are tax planning opportunities for testamentary trusts associated with the availability of graduated rates and tax motivated delays in completing the administration of estates. The Committee strongly believes that an estate (and any resulting testamentary trusts) is fundamentally different from an *inter vivos* trust and the former are not something that a taxpayer "plans" into (i.e. an estate is not generally created by tax advisors to achieve a tax minimization objective, although the Committee recognizes that some estates are set up to obtain tax efficiencies).

The legislation should distinguish between an estate that is merely a holding vehicle for a deceased's assets pending final resolution of the estate's affairs and an estate that is used as a wealth accumulation vehicle. Taxation at the top marginal rate should be applied only to the latter. Generally, an estate is merely a holding vehicle – it is created automatically on an individual's death and as such should not be subject to the proposed 36-month administration period. The tax treatment afforded to an estate should not be determined by an arbitrary administration period that is deemed reasonable for the winding up of an estate. Accordingly, to create fairness between estates that can be administered within 36 months and those that cannot, due to reasons of complexity or challenges by beneficiaries, if the administration period was changed to a "reasonable period of administration". The Committee believes that instead of an arbitrary 36-month administration period, the Department of Finance should consider a specific anti-avoidance purpose test to tax those estates whose main purpose is the accumulation of wealth or whose purpose is tax motivated at a flat top tax rate.

The Proposal states that the "estates of most deceased Canadians are finalized and administered in a timely fashion". The Proposal implies, without citing statistics, that the 36-month period is a reasonable time frame in which to wind-up an estate.

As noted above, there are often non-tax reasons for an estate's administration to require more than 36-months of administration including:

- litigation among beneficiaries that lasts several years or estate challenges by a spouse, child or other dependent who has not been adequately provided for in the will;
  - British Columbia's *Wills Estates and Succession Act*[28] may result in increased litigation in that province as independent children are able to challenge a will;
- estates such as those with assets that are difficult to sell or dispose of or illiquid assets (i.e. the sale of assets with environmental issues, the sale or wind-up of a private company, real estate assets, and farms (including farms that will not be sold but instead will be transferred to children/beneficiaries)); and
- locating assets and beneficiaries, especially if they are in foreign jurisdictions.

[28] Supra at note 2.

We believe a "reasonable period of administration" is simply a more appropriate standard. Parenthetically speaking, the 36-month administrative period appears to be too rigid, the Department of Finance should consider the application of a specific anti-avoidance purposes test for estates whose main objective is the accumulation wealth or whose purpose appears to be tax motivated.

2. The 36-Month Period is Inconsistent with Provincial Legislation

The 36-month period is inconsistent with corresponding provincial legislation. For example, under Ontario's *Estate Administration Tax Act, 1998*[29] the Minister of Revenue may assess or reassess an estate for tax payable within four years after the day that such tax became payable. As a result, estate administrators may be hesitant to wind-up an estate until the reassessment period has expired to limit her/his own personal liability for unpaid tax. The Proposal would result in the estate becoming a flat top rate estate in its fourth year of administration. This issue has not gone unnoticed by the tax community.[30]

Alberta's *Wills and Succession Act*[31] does not provide a time limit for an estate administrator to make an application for probate. Furthermore an estate cannot distribute any assets to the beneficiaries for a period of six months from the granting of probate. Consistent with Alberta, British Columbia's *Wills Variation Act,*[32] does not impose a time limit for an estate administrator to make an application to obtain probate (although if an application has not been made within a year of the deceased's death, beneficiaries may start legal action against the administrator).

We believe a "reasonable period of estate administration" is appropriate as it would allow for the Act to be consistent with the applicable provincial legislation.

3. Transition Rules

Given the Proposal's current wording, it is unclear whether estates that existed before 2016 still have 36-months commencing January 1, 2016 to be administered and finalized. Specifically, the Proposal states that an estate would be considered a flat top-rate estate starting immediately after the 36-month period that "follows the individual's death". Thus, the 36-month period for an individual who died on January 1, 2013 would be January 1, 2016 and it would appear that the estate would be considered a flat-top rate estate at that time. However, the Proposal also states that the measures would apply to "existing and new arrangements for the 2016 and later taxation years". This seems to suggest that the 36-month period for an estate where the individual died on January 1, 2013 would commence on January 1, 2016 which is a contradictory application of the legislation.

Recommendation

The Committee believes that the concerns raised herein would be avoided if testamentary trusts are able to continue to access graduated tax rates, thus the status quo is maintained. This could be accomplished by allowing a "reasonable period of administration" for estates, as opposed to an arbitrary 36-month period of administration.

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[29] S.O. 1998, c.34.
[30] *Using Inter Vivos Trusts in Estate and Family Planning: Alter Ego and Joint Spousal and Common-Law Partner Trusts* by Lucinda E. Main and Troy McEachren (Toronto, Canada: Canadian Tax Foundation), 2011.
[31] Supra at note 3.
[32] *Wills Variation Act*, R.S.B.C. 1996, c. 490. This Act will be replaced by the *Wills, Estates and Succession Act* on March 31, 2014.

If the status quo is not accepted, we believe it is necessary for the legislation to clarify that the period of administration starts the later of January 1, 2016 and the date of the individual's death in order to avoid the contradictory application noted above.

D. CALENDAR YEAR-END

Subsection 249(5) of the Act, in conjunction with paragraph 249(1)(c), permits a testamentary trust to choose any date for its first year-end provided that the taxation year does not exceed 12 months. *Inter vivos* trusts are required to have a calendar year-end per paragraph 249(1)(b) of the Act. The Proposal would require "trusts created by will" and "flat-top rate estates" to have a calendar year-end.

The main concerns with a calendar-year end are as follows:

- the difficulty and inconsistencies in determining the point in time at which a "trust created by will" begins (i.e. note the discussion of the law of assent above);
- possible short year-ends for provisions in the Act that are tied to year-ends (i.e. certain reserves) and the cost of compliance for abnormally short taxation years;
- where a non-calendar year is selected initially by an estate, the cost of preparing an additional tax return if the estate is forced to change year-ends;
- compliance and administrative issues for preparers and trust administrators, which could translate into additional costs for estates and trusts; and
- mutual fund reporting and filing deadlines for calendar year trusts that have significant investment assets.

1. History and Background

In July, 1995, legislation was enacted (subsection 249.1(1) of the Act) to amend the definition of "fiscal period" and to introduce new restrictions on the timing of fiscal periods for determining business and property income. This definition provides that all individuals (other than a testamentary trust) must have a calendar year-end. The purpose of this amendment was to prevent tax deferrals that could arise based on the year-end selected by individuals.

Testamentary trusts have always been carved out from the requirement to have a calendar year-end. We believe this is due to the fact that the date of death is not planned. Therefore, as long as the fiscal period does not exceed 12 months, any year-end is acceptable. Once selected, a year-end cannot be changed without the concurrence of the Minister. Based on the current legislation in respect of a fiscal year for testamentary trusts, we believe the opportunities to defer tax with a testamentary trust are limited.

2. Tax Administration of Trusts

We believe if the Proposal is enacted, the requirement for all trusts to have a calendar year end could have a significant impact on trust companies and other entities that prepare trust returns. This will mean that all of the taxation returns (testamentary and *inter vivos* trusts) will now have to be filed no later than 90 days after the year-end. For businesses and trust administrators that prepare both T1 and T3 returns, almost all of this work will have to be done in a very short window of time. In addition to inconvenience, we believe this could result in higher costs to estates and testamentary trusts. We encourage the Department of Finance to consult directly with trust companies on this issue.

In conjunction with the above, the compliance burden will be further compounded by the fact that the 90-day T3 filing deadline for trusts will coincide with the deadline for the receipt of T3 slips from mutual funds and partnerships. As you know, the Chartered Professional Accountants of Canada outlined their concerns in this respect and we believe they are in continuing discussions with the Department of Finance on this issue.

Many testamentary trusts have significant investment income and the timing of the receipt of T3 slips with the filing deadline for T3 returns will create a significant administrative and compliance burden. The fact that T3 and T5013 information may not be available until early April is a key factor in favour of not selecting a December 31 year-end for a testamentary trust.

Recommendation

We believe that the status quo should be maintained as the timing of a person's death is not planned and the deferral benefits are limited. For the reasons noted above, requiring testamentary trusts and flat top-rate estates to have a calendar year-end will result in additional and unnecessary complexity. We believe that introducing this change simply for the sake of consistency with *inter vivos* trusts is neither a strong reason nor one based on principles of tax policy. Those who administer an estate or testamentary trust generally select a non-calendar year-end and as such, they have made a clear statement that a calendar year-end is not desirable for administrative and other reasons.