THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

L'élimination proposée de l'imposition à taux progressifs des fiducies testamentaires et des autres fiducies

SECTION NATIONALE DU DROIT DES TESTAMENTS, SUCCESSIONS ET FIDUCIES
ASSOCIATION DU BARREAU CANADIEN

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AVANT-PROPOS

L'Association du Barreau canadien est une association nationale qui regroupe plus de 37 500 juristes, dont des avocats, des notaires, des professeurs de droit et des étudiants en droit dans l'ensemble du Canada. Les principaux objectifs de l'Association comprennent l'amélioration du droit et de l'administration de la justice.

Le présent mémoire a été préparé par la Section nationale du droit des testaments, successions et fiducies de l'Association du Barreau canadien, avec l'aide de la Direction de la législation et de la réforme du droit du bureau national. Ce mémoire a été examiné par le Comité de la législation et de la réforme du droit et approuvé à titre de déclaration publique de la Section nationale du droit des testaments, successions et fiducies de l'Association du Barreau canadien.

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I. INTRODUCTION

La Section nationale des testaments, successions et fiducies de l'Association du Barreau canadien (la Section de l'ABC) est heureuse de pouvoir présenter ses observations sur les propositions du ministère des Finances concernant les taux progressifs d'impôt sur le revenu des particuliers prévus par la *Loi de l'impôt sur le revenu* (LIR) dans le cas de certaines fiducies.

L'Association du Barreau canadien est un organisme national qui représente 37 500 juristes, avocats, notaires, professeurs de droit et étudiants en droit dans l'ensemble du Canada. Elle s'est fixé comme objectif prioritaire l'amélioration du droit et de l'administration de la justice. La Section de l'ABC représente les juristes de l'ensemble du Canada qui assistent les clients et les conseillers professionnels dans la réalisation de leurs objectifs en matière de planification successorale.

La Section de l'ABC n'appuie pas l'élimination des taux progressifs dans le cas des fiducies testamentaires. Même si on observe des abus occasionnels dans le cadre de la structure d'imposition actuelle, nous ne sommes pas d'avis que l'élimination complète des taux progressifs d'impôt sur le revenu des particuliers dans le cas des fiducies testamentaires soit la solution appropriée.

Nous pensons que s'il faut apporter des modifications au système actuel, celles-ci devront empêcher de façon efficace l'utilisation de la fiducie comme un moyen d'évitement de l'impôt, tout en permettant que la fiducie continue d'être utilisée dans la planification du bien-être des familles canadiennes.

Nos suggestions peuvent être résumées de la façon suivante :

1. Le système actuel devrait être maintenu avec les règles actuelles anti-évitement visant à prévenir les abus.
2. Si le système actuel n'est pas maintenu, tout nouveau système devrait intégrer l'imposition de la fiducie et du bénéficiaire, au lieu de forcer les fiduciaires de faire rapidement transiter des actifs au travers de la fiducie dans le but d'éviter l'utilisation de la fiducie comme un moyen d'évitement de l'impôt, et de permettre de continuer d'utiliser la fiducie comme un instrument qui contribue à la planification du bien-être émotionnel, financier et physique des familles canadiennes.
3. Si un modèle intégré n'est pas adopté, le système préférentiel actuel d'imposition conféré aux fiducies testamentaires devrait continuer à s'appliquer à tout le moins aux fiducies au profit de l'époux.

II. STATUS QUO

Sufficient reasons do not exist to alter the current system of graduated rate taxation of testamentary trusts. This system has, for most of Canada's history, allowed use of the testamentary trust as a vehicle to provide for families. We disagree with Finance Canada's statement that the current tax treatment of testamentary trusts raises questions of tax fairness and neutrality. In our experience as professional estate practitioners, the overwhelming majority of individuals who incorporate testamentary trusts into their estate planning do not do so primarily for tax planning reasons. The ITA already has effective means to deal with abuse through existing anti-avoidance regimes applicable to trusts and their beneficiaries, particularly through section 104(2) which allows the Minister to effectively tax several designated trusts as one.

The Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada are submitting more thorough reasons on maintenance of the current system. We have reviewed their submissions and fully concur with and endorse their submissions in this respect.

III. INTEGRATION MODEL

A. Testamentary Trust as Instrument for Family Provision

Testamentary trusts are often used to benefit surviving spouses, children, family members and others in a variety of circumstances. These trusts are implemented to separate the title and

management of assets from their intended benefit or function in cases where it is not desirable or socially constructive for the beneficiary to have control of the assets.

Some of the more common circumstances in which testamentary trusts are utilized are:

1. Young Adults

A parent may wish to provide a trust to hold funds or assets for a child until the child reaches a certain age, when the parent expects the child will be mature enough to handle the assets. Often parents choose an age over the age of majority, such as 25, 30 or 35 years of age. A parent can appoint another family member, friend or a professional trustee to manage the funds and assets until the child attains the specified age, giving discretion to the trustee to make prior payments out of income or capital to or for the benefit of the child.

2. Disability

A parent or other family member may wish to provide for a disabled family member. The disability may be physical, psychological or mental. In some cases, the disabled beneficiary may not have the legal capacity to manage funds or other assets. The disabled beneficiary may also be eligible to receive provincial disability or social assistance benefits which are determined by assessing the financial means of the beneficiary. If the assets were left outright to the beneficiary or if a trustee were required to pay out income or capital from a trust, this may compromise the eligibility of the disabled beneficiary to receive the disability or social assistance benefits. More significantly, this may be very financially unwise depending on the nature of the beneficiary's disability and their ability to properly manage their financial affairs. Currently, depending on the provincial laws governing the disability plan or social assistance benefits, the parent may be able to provide a discretionary trust for the disabled family member, which allows the trustee to assist the disabled beneficiary without interfering with the beneficiary's entitlement to provincial disability benefits or social assistance and also protecting the funds for the long-term benefit of the family member with a disability.

3. Addiction

A parent may wish to provide for a child or other family member with an alcohol or a drug dependency or a gambling addiction. The parent may reasonably be concerned that making an outright gift to the child or other family member, or creating a trust entitling the child to all the income, the funds going to the child will facilitate the child's dependency or addiction, and

result in more harm than good. Instead, the parent may choose someone trusted to act as trustee of a discretionary trust. The trustee may apply income and capital in ways that benefit the beneficiary, such as paying for treatment and educational programs and other needs of the beneficiary without giving the beneficiary direct access to funds to use for their dependency or addiction. The terms of the trust may be flexible enough that, if the beneficiary recovers, the trustee can give the beneficiary some or all of the income or capital, including accumulated income. These same considerations can also arise between spouses or common-law partners, and be another motivation to establish a discretionary spousal trust, to protect the surviving spouse or partner with the dependency or addiction issue.

4. Spendthrifts

A will-maker may wish to provide for someone who simply does not handle money well and runs up large debts. Will-makers can create a testamentary trust in their will for the benefit of that beneficiary, giving control to a trustee. Again, the terms may be flexible enough that, if the beneficiary becomes fiscally responsible, the trustee can give the beneficiary some or all of the income or capital, including accumulated income.

5. The Elderly

Individuals may wish to provide for elderly family members, recognizing that, as they age, they may become more vulnerable to financial abuse. Will-maker can create a testamentary trust in their will to ensure that the elderly person will be provided for throughout their life with the trustee protecting the capital of the trust fund to prevent financial abuse by third parties.

6. Infants and Minors

Infants and minors are among the most vulnerable in our society. Testamentary trusts provide a will-maker with the ability to provide for children beyond the will-maker's death while ensuring the assets will be protected and available to the children when they reach adulthood and become mature enough to properly handle the capital.

7. Surviving Spouses

Testamentary trusts are often used by will-makers to protect surviving spouses who may be vulnerable to financial or other abuse because of loss of capacity or other reasons, to deal with blended-family situations, to protect assets if the surviving spouse remarries, to minimize tax consequences on the death of the first spouse (such as loss of OAS), and as a vehicle for charitable giving. We address spousal testamentary trusts more fully below.

These are just a few common circumstances where good estate planning may require a testamentary trust. Each family's and individual's circumstances present unique challenges, and there is no closed list of categories for which good estate planning involves the proper use of testamentary trusts.

In many cases, it is desirable to give the trustee discretion to make payments out of income as well as capital, so payments to or for the benefit of the beneficiary can match the beneficiary's needs. In years where the beneficiary does not require all the income, it can be accumulated for a time when the beneficiary has greater need for the funds or is less vulnerable.

B. The Trust as a Tax Avoidance Measure

There are many bona fide uses for the testamentary trust as an instrument for family provision. Having said this, we acknowledge that the current system of taxation for testamentary trusts has allowed occasional abuses. We believe it would be most appropriate to employ existing anti-avoidance provisions (such as ITA 104(2)) to prevent these abuses. However, if changes are made to the current system, the government must find a method to neutralize use of the trust as a tax avoidance measure while allowing its continued use in planning for the well-being of the family.

As Donovan Waters notes in *The Law of Trusts in Canada*, 4th ed., at p. 637, neutralizing use of the trust as a tax avoidance measure can be accomplished in one of two ways:

1. By "hurrying" property through the trust to be taxed instead in the hands of the beneficiaries.
2. By integrating the taxation of the trust and the taxation of the beneficiary.

Taxing all income accumulated in a testamentary trust at the highest marginal rate would discourage effective estate planning in the circumstances outlined above. It will defeat use of the trust as an instrument to provide for families by forcing families to "hurry" property through trusts. Either will-makers will not give the trustees discretion over payment of income to beneficiaries, or trustees who have been given discretion will be reluctant to accumulate income in trusts because of the punitive tax rate on accumulations (even though it may otherwise be in the best interests of the beneficiary to do so).

Accordingly, we oppose the proposal to tax all trusts at the highest marginal rate.

As Professor Waters states, at page 639:

> 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 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.

C. Integration Model – Expanding the Preferred Beneficiary Election

If the current system is modified, instead of adopting measures that would force trustees to "hurry" trust property through testamentary trusts, the CBA Section suggests a policy that would integrate the taxation of the trust and of the beneficiary. This approach was recommended by the Carter Commission in 1966.[1]

There are several ways that an integration approach could be implemented, but we suggest that one effective method would be to allow trustees and beneficiaries to elect to have accumulating income taxed in the hands of the beneficiary at the beneficiary's marginal tax rate in a manner analogous to the preferred beneficiary election.

The preferred beneficiary election will ameliorate the impact of the proposed changes on disabled beneficiaries who meet the criteria in section 118.3(1) or 118(1) of the ITA, but not all persons with disabilities meet those criteria, particularly ones with psychological disabilities. There are persons with disabilities or addictions which affect their ability to appropriately handle their financial affairs, but would not meet the *ITA* criteria.

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1 See Report of the Carter Commission on Taxation, 1966, Vol. 4, Part B.

There is some relief for trusts for individuals under 21 years old in subsection 104(18), but we doubt that many trusts are drafted to meet the criteria of subsection 104(18). More often, the will-maker wishes to provide discretion to pay income to a minor or young adult beneficiary.

We suggest an election of general application, with restrictions to meet concerns that tax-motivated trusts would be created to allocate income to low income beneficiaries, which would ultimately be capitalized and paid to high income beneficiaries. To meet these concerns, the following criteria could be applicable to the trust:

1. A testamentary trust could be created for only one beneficiary during that beneficiary's lifetime.
2. The trustee may have discretion to pay income or capital to the beneficiary, but no one other than that beneficiary would be entitled to any income or capital during the beneficiary's lifetime.
3. On the beneficiary's death, any capital or accumulated income could then be paid to the remainder beneficiary(ies) set out in the trust, or a beneficiary selected pursuant to a power of appointment.

This arrangement would be flexible to meet the circumstances described in the above examples, together with other circumstances that may be unique. In our view, this approach is preferable to pigeon-holing the beneficiaries and imposing arbitrary eligibility criteria, such as specific tests of disability or specific ages in the case of young beneficiaries.

We see no reason that it should be restricted to specific relationships with the will-maker. If, for example, an uncle of a disabled beneficiary wishes to make a provision for his niece, the election should be available to the trustee and the niece to have accumulated income taxed as income to the niece.

This proposed election is not intended to replace the preferred beneficiary election, but be available in addition to it. The preferred beneficiary election should continue to be available for both testamentary and *inter vivos* trusts with disabled beneficiaries. There are good reasons to include other beneficiaries in trusts for disabled beneficiaries. For example, the trust may include a disabled beneficiary's children, to allow a trustee to use income or capital to benefit the children as well as the disabled parent. If the preferred beneficiary election for disabled beneficiaries were restricted in the manner we have suggested for other testamentary trusts, this would discourage planning that benefits a disabled person's dependents.

Consideration should also be given to allowing an election for trusts with multiple beneficiaries to allocate income to a specific beneficiary, provided an equivalent amount is paid to that beneficiary or to a trust for that beneficiary in a later year. For example, parents may want to create a single trust for all their children until one of them reaches a specified age, at which time the trust is divided into trusts for each child. In that case, the election could be used to allocate income to one of the children, provided the amount is then capitalized in favour of that child's interest in the trust and an equivalent amount is later paid to that child or to a new trust created for that child that meets the criteria above.

IV. SPOUSAL TESTAMENTARY TRUSTS

A. What are spousal trusts?

A spousal or common-law partner trust can be either testamentary (i.e. arising on someone's death) or *inter vivos* (i.e. created during someone's lifetime by way of a trust deed). We refer generally here to post-1971 spousal and common-law partner trusts.

A "spouse trust" is described in subsection 70(6) of the ITA. This allows for taxable capital gains, allowable capital losses, recaptures of capital cost allowance and terminal losses which would otherwise arise as a result of a taxpayer's death, by virtue of the deemed disposition of capital property under subsection 70(5), to be deferred if, as a consequence of the taxpayer's death, the property is transferred or distributed to the taxpayer's spouse or to a trust established in favour of the taxpayer's spouse as described in that section. In addition to Canadian residency requirements, to qualify as a spouse trust, the trust must arise as a consequence of the death of a taxpayer and:

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

Generally, a spouse trust will receive the same tax treatment for the distribution of the assets of a deceased spouse as the surviving spouse would have received had the assets been distributed directly.

B. Uses for spousal trusts

Address blended family situations

In a blended family, testators will frequently provide for a spousal trust in their will to benefit the surviving spouse during the spouse's lifetime with the remainder beneficiaries being the settlor's children. In this way, testators can provide for the spouse during their lifetime, while ensuring that the ultimate beneficiaries are their own children.

Protect vulnerable spouses

Testamentary spousal trusts are utilized in situations where a spouse may be losing mental capacity or is otherwise vulnerable, whether by reason of age, illness, financial vulnerability or required reliance on others for their well-being. A testator may be worried that someone would take financial advantage of the surviving spouse if left to manage more than a modest sum of money or assets. By using a spousal trust, the funds may be protected by the trustee for the long-term benefit of the surviving spouse, without additional tax burden.

Protect assets when surviving spouse remarries or enters into common-law relationship

Testamentary spousal trusts are used by couples wishing to guarantee that their assets will ultimately pass to their children in the event of remarriage of a surviving spouse. Without a spouse trust, if the surviving spouse remarries or enters into a common-law relationship and then dies, all too often the assets flow to the new spouse or partner and the children of the first marriage never receive any assets from their biological parents.

Minimize tax consequences on the death of the first spouse

When the assets of a testator pass outright to their spouse rather than through a testamentary spousal trust, the surviving spouse must transition from two sets of graduated tax rates to one. The tax liability of the surviving spouse will therefore be greater than the former aggregate tax liability of the couple. By using a testamentary spousal trust, the income and capital gains benefitting the surviving spouse are shared between the trust and the surviving spouse, extending the previous tax position until the death of the surviving spouse.

Avoid loss of OAS for a surviving spouse

A testamentary spousal trust often stands in the place of the deceased and can be seen as a legitimate means to continue to 'split' income of the married couple until the second spouse dies. For families of limited means, taxing and capitalizing the income in the spousal trust can

reduce or eliminate the OAS claw back, which can make a significant difference in their financial wellbeing. This is legitimate tax planning based on sound social policy.

Prevent duplication of probate taxes

When the assets of a married or common law couple are held separately or as tenants in common, they must often be probated twice, as they will pass first to the surviving spouse and then, on the death of the surviving spouse, to other beneficiaries. This situation is quite common, particularly in second marriage situations.

Duplication of probate taxes (or probate fees) can be a significant expense in jurisdictions with higher probate rates, such as British Columbia, Ontario and Nova Scotia.

Testamentary spousal trusts provide a mechanism to ensure that the assets of a married or common law couple will flow to the ultimate intended recipients, often children from a first relationship, while having to pass through probate only once, even when they are held individually.

A vehicle for charitable giving

Spousal trusts are frequently used by spouses who wish to ensure that some or all of their assets will ultimately benefit charitable purposes or organizations, while also providing for the wellbeing of their spouse during their lifetime.

C. Why we need to maintain graduated tax rates for spousal trusts

The preservation of graduated tax rates for spousal trusts is consistent with the existing public policy rationale behind other ITA provisions, which seek to equalize income between spouses and defer the tax consequences otherwise arising on the death of the first spouse until the death of the surviving spouse. Examples of other situations in the ITA consistent with this approach are:

- The ability to roll-over assets to a surviving spouse at cost on death.
- The ability to split pension income between spouses.

The loss of graduated tax rates for testamentary spousal trusts would in many cases lead to negative consequences for a surviving spouse, such as:

- OAS claw back.
- Loss of eligibility for long-term residential care subsidies.

Testamentary spousal trusts achieve significant planning goals in the family and society:

- protecting elderly or vulnerable widowed spouses
- addressing the complexity of blended family situations
- protecting assets in the event of remarriage or common-law relationships
- deferring the tax consequences of the death of the first spouse
- preventing the duplication of probate fees, and
- supporting and encouraging charitable intentions.

The proposed elimination of graduated tax rates for testamentary spousal trusts will make estate planning in the best interests of the family and society more costly and therefore less likely to be implemented. The societal costs of this change, particularly in the seniors community, are difficult to calculate but are undoubtedly considerable and will impact a segment of society that can be particularly vulnerable to financial abuse.

V. RELATED INCOME TAX RULES

A. Non-calendar year-ends

The consultation paper identifies related income tax rules that would be affected by changes to the taxation of testamentary trusts. One rule identified is the taxation year of flat top-rate estates and testamentary trusts, which would become the calendar year. Currently, testamentary trusts can use a non-calendar year end (typically coinciding with the date of death of the settlor of the trust).

For clarity, the CBA Section wishes to ensure that the legislation does not affect the ability of an estate which is not a flat top-rate estate (as will be defined in the proposed legislation and as discussed in the consultation paper) to continue to have a non-calendar year-end during the initial period of administration.

Taxpayers and their executors and advisors cannot control when a person dies. Regular estates must continue to have a full year of administration after the date of death before being obliged to file the first T3 return reporting income, gains and losses in that year. Various

income tax rules and provisions apply to transactions that can occur in the first year after death, and these would be affected if the move to a calendar year-end for testamentary trusts and flat-top estates inadvertently affects all estates. This would be particularly problematic for estates of individuals who die late in the calendar year when access to relieving provisions that take effect in the first year of an estate could be circumscribed. This is not the stated position in the consultation paper, but the CBA Section urges caution in drafting any changes.

For flat top-rate estates, a further issue arises as to how a regular estate with a non-calendar year end transitions to a calendar year-end immediately after the 36-month period that follows an individual's death. Is it anticipated that the estate of a person who dies on December 1 of Year 1 will be converted to a flat top-rate estate on December 2 of Year 4 and then have a year-end on Dec 31 of year 4 (it's fourth taxation period)? If so, the short year end in Year 4 could provide significant complications on filing, with many taxpayers and their advisors unaware of the next filing deadline. More significantly, this would create issues with the taxation of estates in connection with existing provisions in the ITA, such as for loss carry-backs, unused charitable donation credits in the estate and similar considerations in which the short year-end could create real financial detriment to an estate well beyond the loss of graduated tax rates.

While the executor of an estate has more flexibility in many cases to choose when to settle and fund a testamentary trust created in the will (contrasted with an estate deemed to become a flat-top estate after 36 months), in many cases, similar issues could apply when the full 36 months (or more) is required to administer the estate, prior to funding the trust which would then be required to have a short first year end to comply with the provisions for non-calendar year ends.

For existing estates and testamentary trusts which currently file on a non-calendar year-end, if not "grandfathered", the move to a calendar year-end would leave those estates with no relief from the possible negative effects of the rules noted above. We see no apparent policy reason for these changes. The change to require only calendar year-ends could cause significant tax liability beyond the loss of graduated income tax rates, which the CBA Section understands to be Finance Canada's primary concern.

The CBA Section recognizes there would be a benefit for administrative purposes in having the tax filing for all estates and trusts generally occur at the same filing due date of March 31.

Further, it might be simpler administratively for the number of testamentary trusts to be reduced in the future, if such trusts do not obtain the benefit of graduated tax rates (other than those established for the legitimate purposes noted elsewhere in this submission). However, the CBA Section questions whether the potential tax issues related solely to the change of year end noted above have been fully analyzed in terms of the effect on the estates and trusts which are currently in existence and will continue in existence for which the motivation behind the creation and the purpose of those trusts is non-tax related, as well as for trusts that will be established in the future on that same basis.

B. Flat top-rate Estates

It is understandable that the government is concerned about estates kept open for an inordinately long time for the sole purpose of continuing to access graduated tax rates. However, there are many non-tax reasons why an estate must be kept open. The following examples are illustrative, not exhaustive:

1. At common law, a person who accepts to be executor[2] holds the office until death (unless removed by a court order). There is no assurance that an estate thought to be fully administered might not call the executor back to duty in future if some actions are required. By way of example, pay equity claims can take years to adjudicate or settle. If a person entitled to share in the payout on that settlement dies before the adjudication or settlement, a lump sum payment would have to be paid to their estate. The executor would become re-involved in the estate even though it may be many years after the death of the testator and be obliged to see to the proper distribution of that asset.

   An expeditious distribution of the newly received settlement funds would mean little or no additional income whose tax treatment need give rise to any concern. However, things may have changed since the executor was last administering the estate. Beneficiaries whose addresses were formerly known may now be difficult or impossible to trace. Or a beneficiary may have died in the interim, requiring the executor to deal with the deceased beneficiary's estate, which can be a complicated affair in itself.[3]

2. A protracted income tax dispute with the Canada Revenue Agency (or any third party) may make the size of the estate uncertain and may require the executor to hold onto estate assets to ensure a sufficient amount on hand to satisfy any liability ultimately determined, whether by a court or by a settlement. Even if there is no dispute, executors may face considerable delays before making final distributions awaiting clearance certificates from Canada Revenue Agency.

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[2] The personal representative is referred to as the "executor", even though different contexts and different in terminology from province to province may make another term more apt.

[3] The difficulty of dealing with the newly found asset can be still more severe if the original executor has died in the meantime.

3. In Ontario, the recent audit and verification authority given to the Minister of Finance under the *Estate Administration Tax Act, 1998* gives the Minister up to four years[4] to (re)assess an estate for additional estate administration tax. Only the executor has standing to contest that (re)assessment. If the executor contests, it will require either a lengthy delay before distribution of the estate, or recovery from the beneficiaries' previously distributed funds or property to fund that contest, for whatever time it may take.
4. Insolvent estates – those where liabilities exceed assets – can generate income but are most problematic to administer. (There is no "beneficiary" for whom income is being earned. Rather, after secured creditors have been paid, anything remaining, including income generated by estate assets, belongs pro rata to unsecured creditors, subject to claims of a higher degree such as compensation to the administrator of the estate, probate fees, federal income tax, funeral and burial costs, or professional fees. In that case, there is nothing inappropriate in allowing the estate to benefit from being taxed on income at graduated rates, no matter how long the process of administration lasts.)
5. Experienced estates practitioners will attest to the fact that litigation involving an estate can last for many years, preventing distribution of the estate. Indeed, when the validity of a will is challenged, it will often require the appointment of an independent personal representative to act on an interim basis, pending the resolution of the dispute, whether judicially or otherwise. Further, until otherwise ordered by the court, this personal representative may have no authority to distribute the estate assets under his or her control.

It appears from the consultation paper that the government has arbitrarily decided that by the end of the 36-month period following an individual's death, the executor should have completed their duties and wound up the estate. However, the examples above show a number of reasons for a protracted delay in winding up an estate, all outside the executor's control. Further, much of the provincial and territorial legislation allowing individuals to advance a claim against an estate, such as dependants relief, will variation, spousal property division claims, prevents the personal representative of the estate from distributing any assets until the resolution of the claims advanced against the estate. This can take many years to resolve. Depending on the nature of the claims and Court determinations, it may not be possible to begin the administration of the estate assets until the Court's decision is rendered and any appeals have been dealt with.

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[4] The Minister has an even longer time to assess or reassess an estate for additional estate administration tax if the person fails to file the prescribed form in the prescribed time, or if "any person made a misrepresentation that is attributable to neglect, carelessness or willful default, or has committed any fraud in supplying any information regarding an estate or in omitting to disclose any information regarding the estate."

Other provisions in the ITA set an arbitrary period of 36 months following the death of a taxpayer as the time period by which a specified action must occur, subject to an extension by written application to the Minister of National Revenue. Two examples:

- Under subsection 70(6), the period for indefeasible vesting of property in a deceased taxpayer's surviving spouse or common-law partner, or in a trust for such a person, in order that the deemed disposition rule in subsection 70(5) not apply to that property.
- Under subsection 248(9), the period for a person to disclaim an interest in a deceased taxpayer's estate in order for the consequential entitlement of another person to be treated, for the purposes of subsection 248(8), as having been acquired as a consequence of the death of the taxpayer.

The policy reflected in these provisions appears to be that, while 36 months is a reasonable time for certain income tax consequences arising on the death of a taxpayer to crystallize, there may be circumstances that warrant a longer period. The arguments in favour of that policy apply equally to the proposal to eliminate the graduated-rate taxation of an estate that continues to be administered for any number of non-tax reasons. For this reason, we propose that, instead of fixing 36 months as the outside period during which an estate should be taxable at graduated rates, any new rule allow for a written application to the Minister of National Revenue to extend that time. In this way, the Minister can consider each estate on a case-by-case basis before determining whether to exercise discretion to extend the time and, if so, the length of that extension. (Presumably, more than one extension ought to be permitted, depending on how events subsequent to the first extension unfold.)

Alternatively, we would support use of a period of "reasonable administration" as suggested in the submission of the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada.

There are many legitimate non-tax reasons for the use of testamentary trusts, the use of a non-calendar year-end for an estate or trust and for the administration of estate to exceed, sometimes significantly, 36 months. Accordingly, the CBA Section recommends further analysis of these many considerations and issues in developing legislation and that the comments and recommendations of the CBA Section should be taken into account.

RECOMMENDATIONS

1. **Leave in place the current income tax treatment of testamentary trusts, for the reasons indicated in this submission and the submission of the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada.**
2. **Expand the availability of the preferred beneficiary election in the manner described in our submission, to avoid forcing the trustee of a testamentary trust to choose between taxation of trust income at the top marginal rate, and inappropriate distributions to the beneficiary.**
3. **If the tax treatment of testamentary trusts is changed as proposed in the consultation paper, create an exception for testamentary spouse trusts.**
4. **Retain the ability to choose a non-calendar year end for a testamentary trust.**
5. **If flat top-rate taxation is to apply to estates after a reasonable period of administration, give the Minister discretion to postpone the commencement date beyond 36 months, or provide a period of "reasonable administration" as suggested in the submission of the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada.**

The CBA Section would be pleased to answer any questions arising from our submission and to discuss the changes proposed in the consultation paper.