



# **The New Estate Donation Rules – The Good, The Bad and the Ugly**

Presented for CAGP-NS

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# Introduction

- Summary of New Rules
  - Testamentary Trusts/Graduated Rate Estates
  - Life Interest Trusts
  - Estate Donations
- Case Study on Charitable Donations
  - Donation by Will
  - Donation through Life Interest Trust
  - Donation with Holding Company
- Planning Principles

*What's the difference between death and taxes?*

Parliament doesn't meet every year to make death worse.

## Summary of New Rules – TTs and GREs

- Elimination of graduated rates of taxation for testamentary trusts (TT's) – 122(1) amended and (2) repealed
- Top marginal tax rate will now apply to trusts created by will and certain estates

## TTs and GREs (Cont'd)

Two proposed exceptions:

1. Graduated rate estate (“**GRE**”) – three part test
  - Means (i) an estate that arose on and as a consequence of an individual’s death, (ii) that is a testamentary trust and (iii) only for 36 months from date of death
  - Must be designated as a GRE by the executors in the estate’s first tax return
  - Only one GRE per taxpayer
2. QDT - testamentary trust established for benefit of disabled individual (i.e. eligible for disability tax credit) are exempt – details beyond scope of this presentation

## TTs and GREs (Cont'd)

- Implications of this change:
  - spousal trusts
  - other tax planned trusts
- Drafting to ensure benefit from full 36 months
- Will not take effect until 2016 and later taxation years
- No grandfathering for testamentary trusts and estates already established
- Practice point – “unwind” current testamentary trusts or revise planning?

## TTs and GREs (Cont'd)

- Testamentary trusts will now have a calendar year end:
  - Existing testamentary trusts without a calendar year end will be deemed to have a year end that ends on December 31, 2015 – may have two year ends in 2015
  - Existing estates that are not GREs (i.e. older than 36 months) -same rule
- May make administration of TT's easier going forward

## TTs and GREs (Cont'd)

- TT loses \$40,000 exemption from alternative minimum tax requirements (treated same as IV trusts) – GREs keep the exemption
- TT will have liability for Part XII.2 tax
- No longer able to make investment tax credits available to beneficiaries



## TTs and GREs (Cont'd)

- GREs (now existing or created later) are different
- Can still choose an off-calendar year end BUT lose this status 36 months post date of death (Note – possible to have 4 Y/E's within one GRE although 2 will be short years)
- On loss of status have a deemed year end and thereafter December 31 year end going forward – two year ends in the same year?
- Only a GRE eligible for 164(6) loss carry back and 112 (3.2) loss restriction
- Only a GRE can make estate donations under the new rules
- No installment obligation for a GRE
- Graduated tax rates apply

## TTs and GREs (Cont'd)

- Note – new 104 (13.3) provides that income paid or payable to a beneficiary can only be taxed under 104 (13.1) or 104 (13.2) in a TT to the extent of any losses in the trust to make taxable income nil

# Life Interest Trusts

- New 104(13.4) will apply to life interest trusts effective January 1, 2016
- Life Interest Trusts (LIT) – trusts which received a rollover on a transfer of property to the trust where a deemed disposition occurs on the death of the surviving life interest beneficiary:
  - Spousal and common-law partner trusts (spouse trusts)
  - Joint spousal and common-law partner trusts (JPTs)
  - Alter ego trusts and self benefit trusts (AETs)

## Life Interest Trusts (Cont'd)

- New provision applies regardless of when trust settled
- Two components on death of the life interest beneficiary (or survivor in a JPT)
  - Deemed year end and deemed disposition occur at end of day of death (new tax year for the trust starts the next day)
  - All income (including realized gains on the deemed disposition) is deemed payable to the life interest beneficiary and taxable on terminal return

## Life Interest Trusts (Cont'd)

- Shifts tax burden from the life interest trust to the estate of the life interest beneficiary
- 160(1.4) also added - provides that the life interest beneficiary and the LIT are jointly and severally liable for taxes owing as a result of 104(13.4)
- While Finance anticipates 160(1.4) to be applied so that the LIT is liable in the first instance, it remains to be seen how CRA will administer
- Also, creates significant possible mismatch of assets (in the trust) and tax liability (in the estate of the deceased beneficiary)

## Life Interest Trusts (Cont'd)

- Note: If the LIT by its terms pays the life interest beneficiary's tax triggered by the deemed disposition under 104(13.4) does that "taint" that estate from being a GRE?
- Yes, given definition of "testamentary trust" in 108(1) (property would have been "contributed to the trust otherwise than by an individual on or after the individual's death and as a consequence thereof")

## Life Interest Trusts (Cont'd)

- Important to maintain GRE status for the reasons noted previously
- LIT also different re loss carry back - normal three year carry back rules in 111 apply not 164(6)
- Creates another mismatch as the LIT owns the asset that can create a loss and now the capital gain is elsewhere and not able to be reduced (and the shares in question cannot be allocated to the shares to the estate as GRE status is gone and 164(6) is not available there either!)

## Estate Donations

- Applicable for 2016 and subsequent taxation years for a death that occurs after 2015
- Donations made in a will, and those made by designation under a Registered Retirement Savings Plan, Registered Retirement Income Fund, Tax- Free Savings Account or life insurance policy, will no longer be deemed to be made by the individual immediately before the individual's death
  - These donations will be deemed to have been made by the individual's estate at the time the property is transferred to a qualified donee, provided the transfer occurs within 36 months after death



## Estate Donations (Cont'd)

- In addition, the executor/trustee of the individual's estate will have the flexibility to allocate the available donation credit among:
  - the taxation year of the estate in which the donation is made
  - an earlier taxation year of the estate **or**
  - the terminal and immediately preceding taxation year of the individual
- Note: to obtain the carry back the donation must be made by a GRE within 36 months of death
  - if estate not a GRE credit only available against the estate's income in year donation made plus 5 year carry forward
- The current annual credit limits will continue to apply (i.e. 100% or 75% of taxable income)

## Estate Donations (Cont'd)

- Property being gifted must be “property that was acquired by the estate on and as a consequence of the death” or “property that was substituted for that property”
- Valuation of donation credit is value on date property transferred to charity – if not cash, could be different than at date of death
- Note – these rules do NOT apply to donations made by a LIT
- Because of 104(13.4), donations cannot be made by LIT’s and claimed against terminal gains



*“Well, we’ve licked taxes—that just leaves death.”*

# Case Study

# Charitable Donation – Gift in Will

- Regular bequest in will (fixed amount, percentage of residue or formula)
- Deduction available in whatever tax year executor makes donation plus carry back and carry forward
- Could be 10 years total (5 years either side)
- Still will likely want it to be on terminal return
- Elimination of capital gain on donation of marketable securities still applies
- Note – Must be a GRE for these rules to apply

## Charitable Donations - Donation through a LIT

- John and Jane have the following in their estate planning:
  - They leave their non registered assets in a spouse trust for each other - each of their assets include securities with accrued gains
  - John and Jane have RRIF's and TFSA's that they leave to each other
  - On the last death, the assets are left to a charity
  - The spouse trust has been structured to give the trustee discretion to allow the donation at the trust level

## Charitable Donations - Donation through a LIT

- Plan well set up under old rules
- 104(13.4) will now cause the income in the spousal trust in the year of death to be in the final return and deem a year end
- Possible solutions include:
  - Do not use a spousal trust as the donations can be made by the surviving spouse's will and will be used against income in the final return
  - Have the spouse's estate as a beneficiary of the spousal trust such that the assets are distributed to the estate and then donated BUT this taints the estate as a GRE and donation credit only available in the estate and not on final return
  - Are other options available to avoid GRE tainting (i.e. payment to estate beneficiaries directly, indefeasible vesting, issuance of promissory note, etc.)
  - Need to consider the importance of the spouse trust and GRE status

## Charitable Donations — Donations of a Holding Company

- Cyril and Gail have substantial assets, the majority held in an Investco
- Their ultimate estate objectives are:
  - Put \$1m in trust for their disabled son Mike
  - Leave the rest of their estate to their favourite charity
  - Protect the bequests from a challenge from their estranged daughter
- The Investco shares are in a joint partner trust to protect against dependant relief challenge and the donation was structured to be available to offset income in the JPT
- They each leave personally held assets to a spouse trust for each other.
- Cyril is no longer competent and cannot change his will



## Charitable Donations – Donation of a Holding Company

- 104(13.4) deems the JPT income to be taxed in the final return of the survivor
- Presumably Investco will be wound up - this creates an inability to use the capital loss and a double tax
- Possible solutions:
  - Wind up JPT and allocate to Cyril
    - not competent
    - his will leaves assets to a spouse trust (cannot change)
  - Wind up JPT and allocate to Gail
    - Set up Son's trust on her death, even if first
    - Consider tax on funds from Investco
    - Bequest to Cyril, if company left intact, cannot be in a spousal trust
    - Can assets left to Cyril then be managed with an enduring Power of Attorney?

## Charitable Donations — Donation of a Holding Company

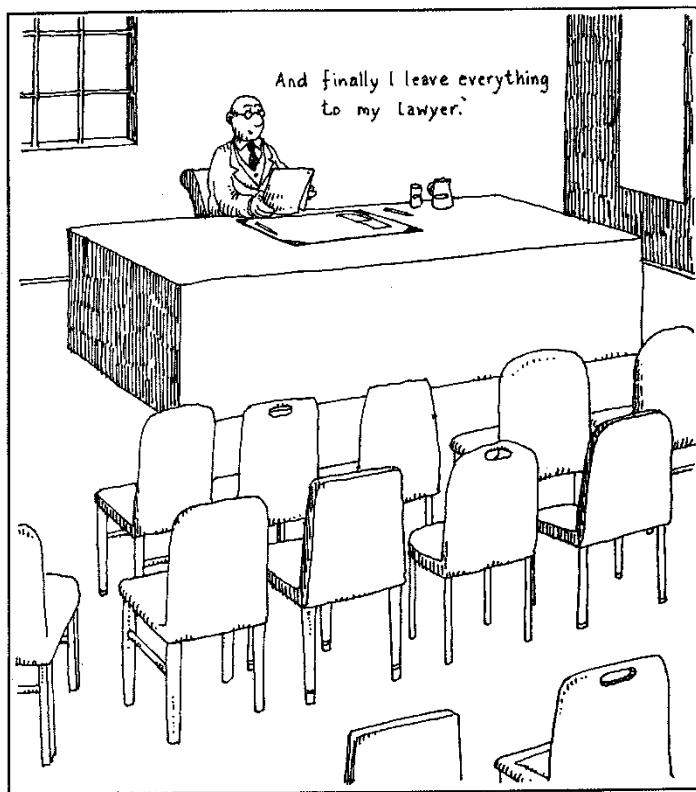
- Wind up Investco now and make donations to reduce tax - not likely to be as tax efficient re: personal funds needed
- The above alternatives ignore a challenge by their daughter - can this be managed outside of a JPT?
- May be a trade-off between asset protection and donation credit
- Modeling may be required to understand that trade-off

## Will Review

- Ensure will has ability to extend the holding of assets in the estate for up to 3 years to take advantage GRE taxation
- Consider clause similar to this:
  - In their discretion, my executors may continue to hold the assets of my estate in trust in the estate for up to three years after my death before distributing the residue of my estate in accordance with the provisions of this will
  - Similar provisions should be added to extend spouse trust if used

# Charitable Remainder Trusts

- These do still work
  - Not affected by the new donation rules because donation credit is claimed at the time of front end funding, not at the time of the back end gift



# Planning Principles

1. Avoid life interest trusts if you can – can you get to the same place in another way?
2. If you must use a life interest trust (because of dependant relief concerns or spousal protection), avoid including private company shares in the LIT
3. If the client wishes to make donations, try to effect those outside of the LIT from other assets or sources (i.e. life insurance, RRSP/RRIF, etc.)

## Planning Principles

4. If the client has capacity, amend documents later in 2015 as January 1, 2016 approaches and consider alternate scenarios in the will or trust which provide for different dispositive provisions if the client dies prior to January 1, 2016 versus after January 1, 2016
5. Consider utility of existing TTs and possible wind-up
6. The wasting freeze approach to planning using holdcos is still appropriate and should be utilized

## Planning Principles

7. Be very careful of blended families to avoid a mismatch of assets and tax
8. Watch out for tainting the GRE and losing marginal rates, estate donation rules and 164(6) carry backs
9. Model the results a lot more frequently than may have been done before to ensure that the client's specific scenario is fully analyzed (particularly when private company shares are involved)

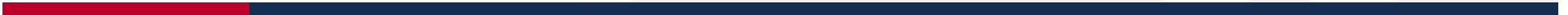


# Conclusion

- A lot of work to do for advisors in next 3.5 months!
- Changes creates opportunities
- Changes create responsibilities

# Questions

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# Thank you!

# Contact Information

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