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SAME GREAT CONTENT!
NEW LOOK!
Several KPMG partners have been criminally prosecuted as part of its agreement with the Justice Department, the firm has had to restrict its tax practice. It cannot provide tax advice to wealthy individuals or packaged tax products, and must accept fees based only on hourly rates.

Closer to home, in the Canadian legal world, the Shepherds case, now destined to be heard by the Supreme Court of Canada, is disturbing on its facts and illustrates the dilemma and resulting litigation fall-out when big law firm partners and tax advisor turns promoter of tax shelter.

More recently, the settlement by a blue-chip law firm, Toov, of over $30 million for potential claims against it by Hollinger International, involving conflict of interest and Conrad Black, has caused a major stir in the Canadian legal community. No doubt, more than one major law firm is whispering, “There but for the grace of God...”

All of the above are very public examples of professional advisors and firms under severe attack for big dollars. What is the major impact on individual practitioners? The inherent tension created by the increasing pressure to attain higher levels of profitability has brought the interests of professional firms out of alignment with the interests of their clients. The problem here, however, is not with the rules of professional conduct, but with individuals who are not following them, a.k.a. “The Greed Factor.”

On a more macro level, perhaps the “corporatization” of professional firms is a prime factor — the expense of professionalization in its purest form. Providers of sophisticated professional services on a global basis must walk and talk like their corporate clients, organizing themselves accordingly. Does this mean the demise of the professional firm and culture as we have known it?

The basis for professionalism is that the client’s interests always come first and the professional’s self-interest is subordinated. Professionals are fiduciaries. Clients give us their trust. They trust that their interests will be primary. In exchange, society allows the professionals the privilege of being self-regulating based on this implicit social contract.

Instead of relying on the simple professionalism that once existed, we no longer see risk management and, as a result, more expense to do business. Worst of all, it means more onerous regulatory requirements for professionals to demonstrate they are worthy of independence.

The Wells already had their own home on the same parcel of land. Rowan survived Wells’s father, but in 1993 predeceased his mother. After the death of Rowan Wells, Blake remained on the property with Isabel Wells until Mr. Wells’s death in 2004. Both before and after Rowan’s death, Blake made contributions to both her home and the property as a whole; and indeed, perhaps your puts in the evidence as to the actual extent of her contributions.

As with Schroff, it was held that Blake had given up an opportunity to purchase her own home. Instead, she put her efforts into the disputed property. Isabel Wells left the whole property to her daughter under will. Blake received 1/7 of residue.

The Court in Blake applied the test for unjust enrichment. It referred to the Pacific National Investments Ltd. decision.

A tale of two trust regimes continued from page 3

That means your client must be able to appoint trustees who live in Alberta, and whom he or she can comfortably call the decision-making — as long as the majority of trustees don’t move or... The trustees’ hold their meetings in Alberta, and none of the core functions — other than investing — should be delegated outside the province, says Rochewych. However, not all clients, especially if he or she is one of the trustees, will be willing to give up decision making control. Second, the core function must be wealthy enough to make it worthwhile the extra cost of setting up a trust in a different province.

The key candidates for the Alberta trust strategy are clients who want to set up inter vivos trusts. There are a number of reasons a client would want to set up an inter vivos trust instead of a testamentary trust. For example, the ability of the Federal Trust Co. of Canada, a national wealth management firm based in Calgary, to put its clients’ interests first, perhaps the client is going to realize a sizable capital gain on assets that he or she has been holding for a long time, perhaps the client’s a large chunk of his or her individual top marginal tax rate.

Another reason for using an Alberta trust is Ottawa’s creation of two special tax vehicles — “deferred gain” and “joint partner” trusts. Usually when a taxpayer transfers assets into a trust, a tax bill comes due. The transferee is deemed owner of assets, according to the Canada Revenue Agency. But taxpayers can transfer assets tax-free into one of these special trusts.

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A tale of two trust regimes

The impact of provincial tax rules on trust creation

Stewart Lewis
Edito, STEP-NS/DC

Preserving wealth and passing it on in a way that meets families needs may be the driver behind estate planning but the estate tax taken can certainly be affected by changing provincial tax rules. Alberta and Quebec are prime examples.

Since 2001, when Alberta brought in the “flat tax” regime, that province’s low rate for individual income and interest has given rise to the Alberta “trust” — an attractive estate planning strategy for high net-worth clients. Alberta’s top marginal rate of 55% in 2005 beat that of all other provinces — for example, 43.70% in British Columbia, 46.41% in Ontario, and 48.22% in Quebec.

However, despite the high tax rate in Quebec, that province has also been attractive for setting up “Quebec trusts.” The strategy behind these trusts is that the trust’s income is taxed at the lower rate of 37.75% rather than 100%, as he expected.

The first prong involves the plaintiff showing that there is no juristic reason from an established class of reasons (contract, disposition of law, donative intent, and other common law, equitable, or statutory obligations) for preventing an unjust enrichment. If the plaintiff is successful in showing some of these reasons, a prima facie case for unjust enrichment is made out. The second prong requires the defendant to rebut such a finding by showing that there was some other reason to deny recovery. This second stage also involved two elements: an analysis of the donor’s expectations of the parties, and public policy considerations.

In the Schrago case, the Court of Appeal held that there was no evidence of many individuals that they were simply an individual’s contract that the parties were present to divide the property that the trust was not communally subject to. A “number of reasons” that there was no reason to prevent the trusts from acting as if they were the resident in the hands of the trust.

It is to be noted that A Tale of Two Trust Regimes chapter 10

In Alberta at the time of death, the partner has the right to make the same claims that a spouse could make at the time of death pursuant to the Determinant Rights Act. However, an AIP does not have the same rights to make claims pursuant to the Dower Act or the Matrimonial Property Act.

Legislation has been proposed in the Province of Alberta to make up for these deficiencies so that people who are happily married or happily in a marriage-like relationship will be treated the same at the time of death of a spouse or partner as a divorced or separated spouse. But this legislation has not been passed to date. Therefore, it does lead to certain inequities in the law leading to some strategically timed separations prior to death.

UNJUSTLY ENRICHING ESTATES by Genevieve Taylor

Association, Legacy Tax & Trust Lawyers, Vancouver, Member, STEP Vancouver

In the two recent cases of Schnogl v. Blac- kene and Schnogl v. Ross, 2005 BCCA 375 and Black v. Ross, 2006 BCCA 79: the British Columbia courts confronted the difficult questions posed when ap- plying the test for unjust enrichment with respect to estates.

The cases dealt with the remedied test for unjust enrichment applied to the Supreme Court of Canada decisions, Garland v. Consumers’ Gas Co., 2004 SCC 25 and Pacific National Investments Ltd. v. Victoria, 2004 SCC 75. In these cases, claims were made by people who contributed to land owned by now-deceased persons.

In both cases, of course, the land passed to third parties on death. In the Schrago case, Mr. Schrago was a non-parent who claimed a proportion of the property on the basis of the estate to his son.

In the Schrago case, the Court of Appeal held that there was more of a familial than a contractual relationship between the Balens and Schnogl. He testified that he did not expect to be paid at the time that he had powers of his own. Schnogl assisted the Balens with maintenance and personal matters and was never paid for such assistance. The extent of his services increased as the Balens aged.

The Balens encouraged Schnogl to stay by telling him he would inherit their home. As evidence, Schnogl showed two foregone opportunities to purchase his own property during the years he resided with the Balens.

In Schnogl v. Blakene, the court awarded Schnogl a 5% interest in the Balen home. The defendants appealed.

The representative of Balen’s estate con- ceded that there had been an enrichment of the Balens and a corresponding deprecia- tion of Mr. Schnogl. Accordingly, the Court of Appeal only needed to consider the third element of the test for unjust enrichment as recently re- stated by the Supreme Court of Canada in Garland, namely, whether there was an absence of a juristic reason for the enrich- ment as determined by a two-pronged ap- proach.

The second prong requires the defendant to rebut such a finding by showing that there was some other reason to deny recovery. This second stage also involved two elements: an analysis of the donor’s expectations of the parties, and public policy considerations.

In the Schrago case, the Court of Appeal held that there was more of a familial than a contractual relationship between the Balens and Schnogl. He testified that he had no interest in the proceeds donated to charity. That will never be executed, however, and a 1973 will that left the entire estate to siblings of the deceased was governed. Schnogl sued Balen’s estate for unjust enrichment.

The trial judge awarded Schnolg a 90% interest in the Balen home. The defendants appealed.

There is a regime in this legislation that has the potential to be used to avoid the income in the hands of the trust. That way the trust could avoid the income in the hands of the trust.

The alternative equivalent wouldn’t have to be made by Quebec’s Revenue Minis- try. That way the trust could avoid provincial taxes altogether.

In the spring, this trust strategy took a serious turn when Quebec Revenue Minis- ter Lawrence Bergmann introduced retro- active legislation aimed at approximately 150 trusts that had not reported any income during the past three tax years. Bergmann’s department is seeking $500 million in un- paid taxes to be paid by the trust. But since Quebec has a separate system, trusts that set up non-Quebec residents were able to make the election on the fed- eral level only, and pay only federal taxes, says Stewart Lewis, a partner with Isabel Noyell LLP, tax lawyers in Montreal.

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Schnogl v. Blackene, which was decided by the Supreme Court of Canada in 1981.

The Revenue Minister,书房, Stewart Lewis, has told Quebec media that there has been an “abuse of the law.”
In the headlines, page 10

Bonne Pratt is a widow who is a Canadian citizen and a resident of Bermuda. Bonnie became a nonresident of Canada six years ago when she sold her longtime home in Ontario.

Bonne has one son, Robert, who resides in Alberta with his wife, Pam, and their four children, all of whom are Canadian citizens. She has no non-Canadian assets that have a value of approximately $20 million. She has decided to settle a trust now with appropriate trust assets. Like remaining assets will be transferred to the trust when she dies under the terms of her will.

The trust created by Bonnie, Robert, and Robert’s children. Bonnie’s main purpose in creating the trust is to help her son fund the education and other costs of his grandchildren. No other purpose will be served by any property transferred to the trust after its creation.

Bonne intends to stay in Bermuda where she is in good health. It is possible that she could move back to Canada if she becomes seriously ill.

Kathy Munro
Partner, PricewaterhouseCoopers LLP Member, STEP Toronto

Creating an inheritance trust that avoids the new offshore rules

Bonnie Pratt is a widow who is a Canadian citizen and a resident of Bermuda. Bonnie became a nonresident of Canada six years ago when she sold her longtime home in Ontario.

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APPLICATION OF PROPOSED NRT RULES

The trust will not be deemed resident in Canada under the proposed NRT rules as long as Bonnie does not become a resident of Canada after she settles the trust. Although Canadian residents are included as beneficiaries of the trust, the trust will not have a “connected contributor” and, therefore, the Canadi ans will not be “resident beneficiaries” as defined under the proposed rules. Therefore, the trust will not be required to file tax returns in Canada or pay Canadian tax to its worldwide income.

When Bonnie dies, her remaining assets will be transferred to the trust. As long as Bonnie remains a nonresident of Canada and her estate is not resident in Canada, the trust should not be subject to the NRT rules after her death.

Since the trust will not be subject to the deemed residency rules, the 21 year deemed recognition rule would have no application to the trust if it does not own any taxable Canadian property.

To the trust if it does not own any taxable

Canadian property.

exist without differences between their re

spective rights.

The Court will determine what the legal and deemed residency rules, the 21 year deemed

fiscal year (under Canadian tax law, this is

The Court relies on the test set out in

spouse at the time of the spouse’s death.

After the death of a spouse, the trust that may be distributed to the benefi-

cy depends on the exercise of the dis-

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APPLICATION OF PROPOSED FIE RULES

An interest in a foreign trust will be subject to the FIE rules if the interest is a “specified interest” as defined in the proposed legislation. A specified interest in a trust specifically excludes an interest under which every amount of income and capital of the trust that may be distributed to the beneficiary depends on the exercise of the discretion of another person or persons.

Therefore, it is important that each of Robert and his children’s interests in the trust be at the discretion of the trustees of the trust so that these beneficiaries won’t be subject to Canadian taxation under the FIE rules.

PLANNING FOR TAX-FREE DISTRIBUTIONS TO THE CANADIAN RESIDENT BENEFICIARIES

In general, a Canadian resident beneficiary can receive distributions of capital from an NRT without the imposition of Canadian tax. A distribution of income, however, will be included in the Canadian beneficiary’s income and subject to tax.

So long as the terms of the NRT permit, any income earned by the trust in a par-
dent trusts that will transform Canada’s app-

roach to taxing such trusts. The fifth round

governmental debate will address child-

related issues and have made recommen-
dations. For example, the subcommittee recommended that this change be made to the QCR.

From the income tax perspective, such a change may also address concerns that “taxable preferred shares” for purposes of the federal Income Tax Act may be created where certain differences in dividend ent-
titlement or liquidation entitlement are drafted to in an attempt to differentiate multiple classes of common shares.

Subsection 23(3) of the QCR states that a share shall not be issued unless the con-
sideration is fully paid in money, property, or past service. For this purpose, s. 23(6) provides that property specifically does not include indebtedness of the person to whom the shares are to be issued or a non-

The crux of the matter is different prin-
ciples that govern matrimonial property law

and succession law. The right to share mat-

rimonial property upon marriage break-
down arises from the view of marriage as a partnership. It presumes that each party contributes equally and independently to the marriage and to acquisition of property, and, therefore, would be entitled to an equal share of the assets acquired during the course of marriage.

Pursuant to succession laws, there is a presumption of testamentary freedom. A person has a right to give his or her assets to whomsoever he or she wishes. Problems arise if a spouse or an adult independent partner is not left appropriate or adequate assets in the partner’s will, or on intestacy at the time of the partner’s death.

Happily married

It parties are happily married at the time of their death and one spouse does not leave all of his or her estate to the other partner in the marriage, the spouse can make a claim against the estate of the deceased spouse pursuant to the Dower Act and the Dependents Relief Act.

The Dower Act allows a spouse to live in a matrimonial home for the rest of their life or to have it rented and to receive the rental income therefore. They also have the right to have the home sold or res-
cumbered by anyone without their consent.

Pursuant to the Dependents Relief Act, a spouse is to be adequately provided with proper maintenance and support by their spouse at the time of the spouse’s death. The Court relies on the test set out in Section 30 of the Succession Law Reform Act, S.B.C. 2009 c. S-7 2009 c. S-7. The Court will determine what the legal and
Atlantic-fishing licences, Ontario corporate law reform, property division in Alberta, and unjust enrichment in British Columbia

Atlantic Canada’s Statutory Fishing Exemption: The Incongruous Transferability of Atlantic Fishing Licences

by Catherine Craig

Baxter Harris Norman Lawyers & Tax Advisors; Prospectice STEP Student Member

The Court’s finding is inconsistent with the Canada Revenue Agency’s (CRA) interpretative position (effective July 1, 2003) that Atlantic Canadian fishing licences cannot constitute a disposition of “eligible properties” under s. 85(1) of the ITA. Under that position, the licences would not qualify for a tax-deferred transfer to a corporation. Consequently, the CRA bases its position on the Crown’s ultimate regulatory control over the licences. Federal fisheries regulations provide that a licence is “the property of the Crown and is not transferable.”

Further, the DOJ’s 1995 “Fleet Separation Program” provisions issuing an inchoate commercial fishing licence to a corporation. The taxation section of the Canadian Bar Association–Nova Scotia expressly disagrees with the CRA’s reasoning. In March 2004, it submitted written arguments to the Federal Minister of Fisheries and Oceans, the Nova Scotia Minister of Agriculture, Fisheries, and the CRA Commissioner. The CBA–NS contends that prohibiting transfer of legal title of a fishing licence is not determinative of whether beneficial rights under the licence constitutes property and are capable of being transferred to a corporation, pursuant to s. 85 of the ITA. The tax section’s submission is consistent with the Nova Scotia Court of Appeal’s Salsen decision.

Specifically, it seems inequitable that a bankrupt taxpayer can be compelled to transfer a beneficial interest in the earnings from a fishing licence to the security holder, while being denied the benefits of incorporating a fishing business due to restrictions on transferability.

Ontario Corporate Law Reform

by Sian Matthews

Ottawa, Bennett Jones LLP; Member, STEP Toronto

The Ontario Ministry of Government Services is in the midst of a multi-year “Business Law Modernization Project” to update Ontario’s commercial laws. Consultation documents have been released by the MGS, and it has requested input on reforming the Ontario Business Corporations Act.

Of particular interest in the context of estate planning and corporate reorganizations are certain stated capital and share rights issues described in the “Consultation Document,” dated May 29, 2006. It is sometimes useful for tax-planning purposes to have multiple classes of shares and, if possible, classes of shares with identical attributes. The Consultation Document recognizes that there has been uncertainty whether classes of shares with identical rights would truly be considered separate classes for corporate law purposes, leading to the doctrine of share attributes with “artificial differences” for greater certainty. The MGS raised the question of whether a legislative clarification is required to confirm that separate classes of shares could

The Canada Revenue Agency stated the following in a letter, dated June 6, 2003: Distribution must be from either income or capital, and the trustee cannot change the nature of income into capital, for example, if the trustee capitalized income during the year and distributed that capitalized amount to the capital beneficiary in the same year, it would nevertheless constitute a distribution of income for tax purposes. While the trust agreement may permit this to be done, the tax effect is that the trustee would be distributing income.

To facilitate tax-free distributions to Robert and his children, all income of the trust should be accumulated and added to the capital of the trust at the end of the year. In early January, before any new income is earned, the trust can distribute the accumulated income as capital payments to Robert and his children.

Bonnie moves back to Canada

APPLICATION OF PROPOSED NRT RULES

If Bonnie moves back to Canada after the trust is created, she will be a “contributor” and a “resident contributor” to the trust under the proposed NRT rules, such that the trust will be deemed resident in Canada for the calendar year that she returns to Canada and for each subsequent year that she remains in Canada.

If Bonnie moves back to Canada within 60 months of transferring the property to the trust, the trust will be deemed resident in Canada from its creation date because Bonnie would not have made the contributions during a “resident time” as that term is defined in the draft legislation. If the trust is not subject to the deemed residency rules from its creation date, the trust will generally be deemed to have disposed of and reacquired its assets at fair market value for Canadian tax purposes immediately. The deemed residency rules apply to the trust.

APPLICATION OF S. 75(2) AND S. 1074.1 OF THE ITA

Since Bonnie contributed the assets to the trust and she is a capital beneficiary, all income earned on the property (or substituted property) and all realized capital gain or losses on the trust’s property (or substituted property) will be attributed to Bonnie for Canadian tax purposes under s. 75(2) once she is resident in Canada. This will be the case, even if the income and realized taxable capital gains were paid to the trust’s beneficiaries.

Double Canadian taxation should not arise since the trust and the beneficiaries would not be taxable on the attributed amounts. However, if the trust pays foreign tax on its income, the overall tax will be higher than it would be if s. 75(2) had no application. Although s. 75(2) will attribute the income to Bonnie, it does not attribute the foreign taxes paid by the trust to her.

If s. 75(2) applies, s. 1074.1 will deny the rollover of the trust’s appreciated properties to any beneficiary other than Bonnie during her lifetime. If Bonnie is still living immediately before the 21st anniversary of the trust, the appreciated assets cannot be transferred to Robert and his issue on a tax-deferred basis. Rather, the trust can distribute the appreciated assets only to Bonnie if she is still a Canadian resident. This will be the case, even if Bonnie returns to Canada and dies within the 21-year deemed realization period.

If Bonnie is excised from the class of beneficiaries, s. 75(2) and s. 1074.1 may not apply. The trust would be required to report its worldwide income and pay Canadian tax on the income and realized taxable capital gains that are not paid in the year (or declared as payable in the year) to a beneficiary.

TAX IMPLICATIONS THAT ARISE AFTER BONNIE’S DEATH

When Bonnie dies, her Canadian resident estate will be a “resident contributor” and a “connected contributor” to the trust, since her remaining assets will be transferred to the trust in accordance with her will. Bonnie will also be a “connected contributor” to the trust, with the result that Robert and his children will each be “resident beneficiaries” of the trust. Therefore, the trust will continue to be deemed resident in Canada even after her death and will generally continue to be the sole beneficiary of the trust’s income. As a deemed resident trust, the trust will be required to report and pay Canadian tax on its worldwide income that is not paid or declared as payable to the beneficiaries.

Conclusion

In summary, because the trust will be subject to corporate income tax and all realized capital gains or losses on the trust’s property (or substituted property) will be attributed to Bonnie for Canadian tax purposes under s. 75(2), any future owner of the trust will be subject to the proposed deemed residency rules.

Furthermore, if Bonnie returns to and dies in Canada, her will could leave the inheritance directly to her Canadian beneficiaries or to a domestic trust for their benefit. Since an offshore trust will be subject to the proposed deemed residency rules, it is important to consider whether the trust will be caught by Canada’s deemed residency rules. Even if a Canadian resident will not be contributing directly to an NRT, numerous transactions are deemed to be contributions to an offshore trust under the new rules, with the result that the trust can inadvertently be subject to tax in Canada under the NRT rules.

Careful analysis and planning is required to ensure an offshore trust will not be caught. In addition, if any Canadian residents will have an interest in the NRT, their interests should be fully discretionary so that their interests will not be subject to Canadian taxation under the proposed FIRE rules.

LEGAL ANALYSIS

by Sian Matthews

Since Bonnie is a resident of Bermuda, she should seek Bermudian counsel to discuss her estate plan. In particular, Bonnie should have an up-to-date will to deal with the one-third of her half of assets that won’t presently be gifted to the Bermuda trust.

However, it is unclear precisely what his issue’s interest in the Bermuda trust will be subject to the FIRE rules if his interest is a “specified interest.” A specified interest in an offshore trust specifically excludes an interest under which every amount of income and capital of the trust that may be distributed to the beneficiary depends on the exercise of the discretion of another person or persons. Therefore, it is important that the interests of Robert and his children be carefully considered.

The STEP study, page 6

STEP INNOXIDE • VOLUME 5 • NUMBER 4
The Qualified Practitioner route requires students to research, prepare, and submit three essays (2,500 to 3,000 words each) based on a topic selected from three of the four broad areas: law, accounts and administration, taxation, and international practice. Each of these areas contains three possible topics. And each topic is broad enough to permit students to select essay ideas relating to their particular area of practice. The Qualified Practitioner route takes approximately six years to complete.

The Qualified Practitioner route is open to persons who hold one of the following recognized professional designations: CFP, CGA, CLU, FCMA, FCSI, or MTI. Candidates must also have a minimum of two years post-qualification practical experience in trusts or estate-related matters.
The Qualified Practitioner route requires students to research, prepare, and submit three essays (2,500 to 3,000 words each) based on a topic selected from three of four broad areas: law, accounts and administration, domestic and international tax, and international practice. Each of these areas contains three possible topics. And each topic is broad enough to permit students to select essay ideas relating to their particular area of practice. By consulting with colleagues, mentors, and other more senior members of their firms, students are able to identify topics about which they (or their firms) are curious, as well as areas of their practice for which they (or their firms) require clarification or elucidation. Candidates are expected to demonstrate a depth of understanding and originality of thought in addressing issues that are at the forefront of professional practice. They are expected to consider relevant legislation, case law, current accounting principles, and administration procedures appropriate to the subject chosen.

The level of ability to be displayed should correspond with written work submitted for a university degree. The quality should merit publication in a professional journal. In the process of researching a topic and integrating their thoughts, students should acquire knowledge and deepen their understanding of trusts and estates. They should be enhancing their professional skills, and ability to carry on their day-to-day practice.

Encourage a colleague to consider STEP student membership.

by Carol Dalgado

The Qualified Practitioner route is for students who have completed the “Qualified Practitioner” course of study for STEP, as well as a part-time Masters of Laws (Trusts) through the professional development program of Osgoode Hall Law School of York University. I decided to apply for STEP membership because my law practice focuses on trusts and estates. I also like the fact that STEP members are professionals who come from a variety of disciplines (accounting, trusts, insurance, finance, and law), all of whom are involved in various aspects of the planning and administration of trusts and estates.

It was surprising to learn at the STEP Canada 2006 National Conference that I was the first Canadian student to complete the QP route. That said, I understand that several students are currently enrolled in the QP program, and that student membership in STEP has been growing steadily. If you know anyone whose practice has a significant trusts and/or estates component, encourage them to consider STEP student membership. It’s a great way to keep informed of developments in trusts and estates, and to expand your network with other professionals who practice in the area.

2006 CRA roundtable
by Robin MacKnight

One of the highlights of the annual STEP National Conference is the “Qualified Practitioner” roundtable. Once again this year we were fortunate to be able to enlist the active participation of senior officials of the Trusts and International sections of the CRA Rulings Division.

STEP branches from across the country generated a number of questions. The CRA also volunteered several questions, which had arisen from various taxpayer inquiries or have been raised at other conferences.

STEP welcomes the active and positive contribution of our CRA colleagues, and hope this reflects recognition that STEP members are valuable allies in promoting tax compliance in the trust and estate sector.

All told, the original list of questions that were raised last year cut back to a manageable 15 for discussion by Ann Marie Humann and Grant Nash, rulings officers from the Trusts section of the Income Tax Rulings Directorate of the CRA, and Paul LeBeaux and Kim Moody, respectively, Chair and Deputy Chair of STEP Canada.

The questions covered planning and compliance issues within the domestic and international arenas.

DOMESTIC CONCERNS

Domestic issues included discussion of concern raised in a recent Auditor General’s report that financial statements might soon be required for trusts. The CRA confirmed that this is not contemplated in the immediate future.

Another question examined the conventional wisdom that a trust with no income need not file a tax return. The CRA confirmed that this thinking, and confirmed that trusts must file the annual “tax and information return.”

Other issues addressed included the following:

• Whether a testamentary trust that pays premiums for insurance on a surviving spouse to meet tax on the second death can be tainted. (It can.)

• How to recognize “prenue loans.”

• How to deal with costs of disposition of assets in estates and trusts.

The CRA had encouraging news on the compliance front. It has reached agreement with the Investment Funds Institute of Canada on how to report income and return of capital where investors receive payments from income trusts. Hopefully, this new policy will ease the compliance and reporting burden.

INTERNATIONAL CONCERNS

On the international front, there was a useful discussion about the practical problems surrounding clearance certificates, including how to deal with delays in processing and distributions from trusts.

The CRA also confirmed that the various problematic foreign information reporting forms are apparently leading to some audit results, so we should not expect any changes to, or relief from, filing any time soon.

In the interim, the CRA has discontinued its voluntary disclosure program relating to foreign reporting, so delinquent taxpayers could now face penalties.

For full written responses from the CRA to the questions raised at the roundtable, please see “Conference Roundtables” at www.step.ca.

Meanwhile, we look forward to next year’s roundtable, urge all STEP branches to submit questions, and hope that our collaborative relationship with CRA continues to grow.

The Tax study continued from page 5

be at the discretion of the trustees of the trust so that these beneficiaries won’t be subject to Canadian taxation under the FIE rules. This would generally require the creation of a fully discretionary trust, leaving the allocation of the income and capital among the beneficiaries at the discretion of the trust company in Bermuda.

However, many settlors are uncomfortable when the trustees are accorded wide discretion under the trust deed, and in particular where the trustees have little personal knowledge of the beneficiaries and their circumstances. A non-binding written declaration of the settlor’s wishes with respect to income and capital distributions and final devolution of the trust property often accompany a discretionary trust as a method of guiding the trustees in this regard. As the examples in the letter of wishes must not be legally binding on the trustees in order to preserve the discretionary nature of the trust.

When drafting the letter of wishes, consideration must be given to CRAs administrative position on the letter of wishes as expressed in CRA Document No. 2000-0021997. In that document, the CRA states that where a letter of wishes is signed and dated, it may be construed to be part of the trust deed itself. Therefore, where a letter of wishes deals with distribution of income and capital and devolution of trust property upon termination, it may be that the trust is no longer considered discretionary, in the view of CRA. Accordingly, Canadian tax advice should be sought when drafting any letter of wishes.

The Bermuda trustees should be made aware of the tax consequences of improperly documenting distributions of capital from the trust. As noted above, to ensure that distributions from the trust to Robert and his children no earlier than the capital of the trust at the end of the year.

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Encourage a colleague to consider STEP student membership.

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The STEP study, page 6

In summary, because the trust will be subject to the NRT rules if Bonnie moves back to Canada, Bonnie may wish to reconsider the estate plan. In particular, Bonnie should seek Bermudian counsel to discuss her estate plan. In conclusion, in creating an offshore trust, it is important to consider whether the trust will be caught by Canada’s deemed residency rules. Even if a Canadian resident will not be contributing directly to an NRT, numerous transactions are deemed to constitute contributions to new rules, with the result that the trust can inadvertently be subject to tax in Canada under the NRT rules.

Legal analysis by Siân Matthews

Since Bonnie is a resident of Bermuda, she should seek Bermudian counsel to discuss her estate plan. In particular, Bonnie should have an up-to-date will to deal with the estate, for the benefit of Robert and his children, if she is still a resident of Canada when she dies. In conclusion, in creating an offshore trust, it is important to consider whether the trust will be subject to the NRT rules. Even if a Canadian resident will not be contributing directly to an NRT, numerous transactions are deemed to constitute contributions to new rules, with the result that the trust can inadvertently be subject to tax in Canada under the NRT rules.

Siân Matthews
Senior, Bennett Jones LLP; Member, STEP Calgary
Creating an inheritance trust that avoids the new offshore rules

Bonnie Pratt is a widow who is a Canadian citizen and a resident of Bermuda. Bonnie became a nonresident of Canada six years ago when she sold her longtime home in Ontario.

Bonnie has one son, Robert, who resides in Alberta with his wife, Pam, and their four children, all of whom are Canadian citizens. She has non-Canadian assets that have a value of approximately $20 million. She has decided to settle a trust now with an appreciation rate of her assets. Like remaining assets will be transferred to the trust when she dies under the terms of her will.

The trust’s investment portfolio will be a trust company that is resident in Bermuda. The beneficiaries of the trust will include Bonnie, Robert, and Robert’s children. Bonnie’s main purpose in creating the trust is to help her son fund the education and other costs of his grandchildren. No other person will acquire or acquire property to the trust after its creation.

Bonnie intends to stay in Bermuda while she is in good health. It is possible that she could move back to Canada if she becomes seriously ill.

Kathy Munro
Partner, PricewaterhouseCoopers LLP; Member, STEP Toronto

TAX LEGISLATION ANALYSIS by Kathy Munro

In its 1999 Federal Budget, the Minister of Finance proposed new rules for non-resident entities that will transform Canada’s approach to taxing such trusts. These rules, which took effect in 2005 and is generally effective for taxation years that begin after 2002. Under the proposed rules, if a Canadian resident contributes property to an NRT, the trust is generally deemed resident in Canada for a number of purposes, and the corporation, the NRT, and certain Canadian resident beneficiaries may all become

APPLICATION OF PROPOSED NRT RULES
The trust will not be deemed resident in Canada under the proposed NRT rules as long as Bonnie does not become a resident of Canada after she settles the trust. Although Canadian residents are included as beneficiaries of the trust, the trust will not have a “connected contributor” and, therefore, the Canadians will not be “resident beneficiaries” as defined under the proposed rules. Therefore, the trust will not be required to file tax returns in Canada or pay Canadian tax on its worldwide income.

When Bonnie dies, her remaining assets will be transferred to the trust. As long as Bonnie remains a nonresident of Canada and her estate is not resident in Canada, the trust should not be subject to the NRT rules after her death.

Since the trust will not be subject to the deemed residency rules, the 21-year deemed realization rule would have no application to the trust if it does not own any taxable Canadian property.

APPLICATION OF PROPOSED FIE RULES
An interest in a foreign trust will be subject to the FIE rules if the interest is a “specified interest” as defined in the proposed legislation. A specified interest in a trust specifically excludes an interest under which every amount of income and capital of the trust may be distributed to the beneficiary depends on the exercise of the discretion of another person or persons.

Therefore, it is important that each of Robert and his children’s interests in the trust be at the discretion of the trustees of the trust so that these beneficiaries won’t be subject to Canadian tax under the FIE rules.

PLANNING FOR TAX-FREE DISTRIBUTIONS TO THE CANADIAN RESIDENT BENEFICIARIES
In general, a Canadian resident beneficiary can receive distributions of capital from an NRT without the imposition of Canadian tax. A distribution of income, however, will be included in the Canadian beneficiary’s income and subject to tax.

So long as the terms of the NRT permit, any income earned by the trust in a particular year that is not distributed to beneficiaries can be accumulated and added to the capital of the trust after the end of the fiscal year (under Canadian tax law, this is deemed to be the calendar year unless the trust is a testamentary trust). After the end of the fiscal year, such capitalized income will be available for distribution as capital payments.

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A tale of two trust regimes

The Impact of provincial tax rules on trust creation

then moral duty to the spouse, then make a fair division of property at the time of someone’s death.

Unhappily separated or divorcing

In these circumstances, the surviving spouse can make claims against the estate of a deceased spouse pursuant to the Dower Act and the Dependants Relief Act as it has legally married. In addition, he or she can make a claim pursuant to the Matrimonial Property Act.

If couples are separated at the time of their death, or divorced for a certain period of time, a spouse has an additional right to make a claim against the estate for the division of matrimonial property under the Matrimonial Property Act. Only those spouses who are experiencing marriage breakdown and who meet the relevant requirements can bring an action under the Matrimonial Property Act in Alberta.

A claim for a matrimonial property order requires these conditions:

• a divorce judgment has been granted or a declaration of nullity has been made,
• an order of judicial separation has been granted,
• the spouses have been separated for one year (or less if there is no possibility of reconciliation),
• the spouses are living apart and one intends to transfer or has transferred property intending to defeat the claim of the other, or
• the spouses are living apart and one is dissipating property.

A spouse has a right to start a Matrimonial Property Act action after the death of a spouse if the action could have been commenced immediately before the death of the spouse. The estate of a deceased spouse does not have the right to commence an action against the surviving spouse for the same cause that existed until it became absolutely final. Schnogl assisted the Balens with maintenance and personal matters and was never paid for such assistance. The extent of his services increased as the Balens aged.

The Balens encouraged Schnolg to stay by telling him he would inherit their house. In the Schoog case, Mr. Schnogl was a long-time tenant of Mr. and Mrs. Balen, residing in a basement suite in their home. The relationship between tenant and landlord, according to the courts, was more a familial than a landlord-tenant relationship.

Alberta at the time of death, the partner has the right to make the same claims that a spouse could make at the time of death pursuant to the Dependants Relief Act. However, an AIP does not have the same rights to make claims pursuant to the Dower Act or the Matrimonial Property Act.

Legislation has been proposed in the Province of Alberta to make up for these deficiencies so that people who are happily married or happily in a marriage-like relationship will be treated the same at the time of death of a spouse or partner as a divorced or separated spouse. But this legislation has not been passed to date. Therefore, it does lead to certain inequities in the law leading to some strategically timed separations prior to death.

UNJUSTLY ENRICHING ESTATES by Genevieve Taylor

In the two recent cases of Schnogl v. Blazevich, 2005 BCCA 275 and Blazevich v. Ross, 2006 BCCA 799, the British Columbia courts confronted the difficult questions posed when applying the test for unjust enrichment with respect to estates.

The cases dealt with the remedied test for unjust enrichment applied in the Supreme Court of Canada decisions, Garland v. Consumers’ Gas Co., 2004 SCC 25 and Pacific National Investments Ltd. v. Victoria, 2004 SCC 75. In these cases, two claims were made by people who contributed to a household owned by now-deceased persons. In both cases, of course, the land passed to third parties on death.

In the Schoog case, Mr. Schnogl was a long-time tenant of Mr. and Mrs. Balen, residing in a basement suite in their home. The relationship between tenant and landlord, according to the courts, was more a familial than a landlord-tenant relationship. Schnogl assisted the Balens with maintenance and personal matters and was never paid for such assistance. The extent of his services increased as the Balens aged.

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A similar situation to the Schoog case occurred in Blazevich v. Ross. In that case, the plaintiff, Mr. Blazevich, was a long-time tenant of the Blazeviches. He was employed by the deceased Mr. Blazevich and present when the deceased Mr. Blazevich was killed.

The trial judge awarded Schnogl a 50% interest in the Balen home. The defendants appealed.

The representative of Balen’s estate conceded that there had been an enrichment of the Balens and a corresponding deprivation of Mr. Schnogl. Accordingly, the Court of Appeal only needed to consider the third element of the test for unjust enrichment as recently re-stated by the Supreme Court of Canada in Garland, namely; whether there was an absence of a just reason for such enrichment as determined by a two-pronged approach.

The first prong involves the plaintiff showing that there is no just reason from an established class of reasons (contract, disposition of law, donative interest, and other common law, equitable, or statutory obligations) preventing a finding of unjust enrichment. If the plaintiff is successful in showing some or all of these reasons, a prima facie case for unjust enrichment is made out. The second prong requires the defend-ant to rebut such a finding that there was some other reason to deny recovery. This second stage also involved two different types of analysis of the previous expectations of the parties, and public policy considerations.

In the Schoog case the Court of Appeal held that there was more of a familial than a contractual relationship between the Balens and Schnogl. He testified that he did not expect to be paid at the time that he continued to live with and provide services to them were clear. As a result, Schoogl was awarded 60-75% of the prop-erty, rather than 50%, as expected.

A similar situation to Schoog arose in the Blazevich decision. In that case the plaintiff, Mr. Blazevich, entered into a residence tenancy with the Blazeviches and later a legal marriage, with Rowan Wells, the son of Isabel and Roy Wells. Wells and Mr. Blazevich have cohabitated in a home on the senior Wells’ property in 1972.
Professional advisors are under attack

Several KPMG partners have been criminally prosecuted as part of its agreement with the Justice Department, the firm has had to restrict its tax practice. It cannot provide tax advice to wealthy individuals or pre-packaged tax products, and must accept fees based only on hourly rates.

Closer to home, in the Canadian legal world, the Bowker case, now destined to be heard by the Supreme Court of Canada, is disturbing in its facts and illustrates the dilemma and resulting litigation that fall out when big law firms and tax advisor turns promoter of tax shelters.

More recently, the settlement by bliss-hip law firm, Toyn, of over $30 million for potential claims against it by Hofferfling International, involving conflict of interest and Conrad Black, has caused a major stir in the Canadian legal community. No doubt, more than one large law firm is whispering “There but for the grace of God . . .”

All of the above are very public examples of professional advisors and firms under severe attack for big dollars. What is the major impact on individual practitioners? The inherent tension created by the increasing pressure to attain higher levels of profitability has brought the interests of professional firms out of alignment with the interests of their clients. The problem here, however, is not with the rules of professional conduct, but with individual clients who are not following them, i.e., “The Greed Factor.”

On a more macro level, perhaps the “corporatization” of professional firms is a prime factor — the expense of professionalization in its past form. If providers of sophisticated professional services on a global basis must walk and talk like their corporate clients, organizing themselves accordingly, does this mean the demise of the professional firm and culture as we have known it?

The basis for professionalization is that the client’s interests must always come first and the professional’s self-interest must be subordinate. Professionals are fiduciaries. Clients give us their trust. They trust that their interests will be primary. In exchange, so-ciety allows the professionals the privilege of being self-regulating based on this implicit social contract.

Instead of relying on the simple professional that once took quite well, we face more risk management and, as a result, more expense to do business. Worst of all, it means lowering regulatory re-quirements for professionals to demon-strate they are worthy of independence.

While there was some discussion of the first two elements of the test, the primary focus was again whether there was a juris-AMERICA

A tale of two trust regimes continued from page 3

That means your client must be able to appoint trustees who live in Alberta, and/or whom he or she can comfortably locate the decision-making—as long as the majority of trustees don’t move or . . .

The business strategy behind their meetings in Alberta, and none of the core functions—other than investing—should be del-egated outside the province, says Rochwerg.

However, not all clients, especially if he or she is one of the trustees, will be willing to give up decision-making control. Second, the costs might be too high or it may make it worth the extra cost of setting up a trust in a different province.

The principal candidates for the Alberta trust strategy are clients who want to set up inter vivos trusts. There are a number of reasons a client would want to set up an inter vivos trust instead of a testamentary trust. One of these is the requirement of the trust by the Court of Trade Trusts of Canada, a national wealth management firm based in Calgary. For many lawyers, a big hang-up is the client going to realize a sizable capital gain on assets that he or she has been hold-ing for, or perhaps the client is going to take receipt of a large dividend from his or her company. In both cases, the client will want to avoid paying his or her individual top marginal tax rate.

Another reason for using an Alberta trust, as Thompson LLP in Toronto, spoke about provincial rate planning at the 2006 STEP Canada National Conference. The W ells already had their own home on the same parcel of land. Rowan W ells survived his father, but in 1993 predeceased his mother. After the death of Rowan W ells, Blake remained on the property with Isabel W ells until Mrs. W ells’ death in 2004. Both before and after Rowan W ells’ death, Blake made contribu-tions to both her home and the property as a whole, not just gifts, perhaps more put in the evidence as to the actual extent of her contributions.

As with Schroff, it was held that Blake had given up an opportunity to purchase her own home. Instead, she put her efforts into the disputed property, Isabel W ells left the whole property to her daughter under her will. Blake received 1/5 of resale.

The Court in Blake applied the test for unjust enrichment. It referred to the Province’s National Investments Ltd. case. And where a connection to the land existed, the Court held it worth the extra cost of setting up a trust in a different province.
# BRANCHING OUT

## STEP events across Canada

### MONTREAL

- **Date:** November 29, 2006
- **Location:** Royal Bank of Canada, 1 Place Ville-Marie, Suite 4100
- **Speakers:** John Claxton, Jacques Beauine

### OTTAWA

- **Date:** October 18, 2006
- **Topics:**
  - When things go bad: Civil penalties, anti-avoidance and tax evasion
  - Advising the advisor: How to preserve integrity and minimize potential risk in dealing with clients
- **Location:** TBA
- **Speakers:** TBA

### VANCOUVER

- **Date:** October 26, 2006
- **Topic:** Insurance and benefit planning
- **Location:** TBA
- **Speakers:** TBA

### DECEMBER 7, 2006

- **Topic:** CRA roundtable
- **Location:** TBA
- **Moderators:**
  - Chris Falk, McCarthy Tetrault LLP
  - Claude Rinfret, Deloitte & Touche LLP

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# CHAIR’S MESSAGE

## World’s best STEP conference attendance

by Paul LeBreux
Chair, STEP Canada

More than 400 participants attended the STEP Canada 8th National Conference on June 12–13 in Toronto — a new benchmark for attendance. The conference continues to attract more delegates than any other STEP conference worldwide.

The delegates enjoyed two days of proceedings that covered an array of topics ranging from purely domestic issues to some of the more innovative and exotic international planning opportunities.

A key objective when planning this year’s event was to offer diversity across the legal, accounting, financial planning and insurance disciplines. This is always a significant challenge that we face at STEP given its multidisciplinary membership. However, based on feedback, we believe we were successful in striking the right balance across the disciplines and in the selection of workshops and plenary sessions.

We are also pleased to report that we had the highest number of sponsors yet for this year’s program. Sponsors play a supportive role in our organization, and we truly value the contributions they make, not only during the National Conference but also throughout the year. Our thanks goes out to them for their continued support.

This year’s social event was held at the at the Windows restaurant in the Rogers Centre, allowing delegates the opportunity to socialize while watching the Blue Jays play the Baltimore Orioles. It was a fabulous way to reconnect with delegates.

Plans for next year’s event are already underway, and if this year’s success is any indication, you’ll want to register early. We look forward to seeing you Thursday, June 7 and Friday, June 8, 2007 in Toronto.

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