

## Chapter Five Review Questions and Answers

### QUESTIONS

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1. Consider each of the following trusts. Indicate when the first T3 Return is required to be filed. Briefly explain your answer.
  - (a) The Purple Family Trust settled by Joseph on June 12, 2009.
  - (b) Joseph established an alter ego trust on December 1, 2009.
  - (c) Robin, Joseph's wife, provided for a qualifying spousal trust in her Will. She died on December 31, 2009.
  - (d) Joseph died on January 30<sup>th</sup>, 2010 leaving an estate worth \$2,000,000 including 100% of the shares in his small business corporation Joco Ltd. worth \$800,000. Joseph's Will provides that his two sons inherit the shares of Joco Ltd. as long as they pay the income tax relating to the capital gain on the shares resulting from Joseph's death.
  
2. Maria died with a \$500,000 investment portfolio in high risk equities. The value of the portfolio diminished to \$150,000 in the 6 months following Maria's death when all the shares were sold for a loss.
  - (a) What should the executors consider with respect to utilising this loss when filing the T-3? Explain your answer.
  - (b) How might this affect the decision regarding the choice of year end for the estate?
  
3. Although a trust is taxed as an individual, there are some differences. Briefly describe these differences.

The remaining questions refer to the Neverland Trust.

4. Examine the T3 for the Neverland Trust. Briefly explain the purpose of Questions 1, 5, 7, and 9 under "Other required information" on page 2.
  
5. \$5,500 was deducted from other investment income on the schedule for "Allocation of income and expenses". Briefly explain why.
  
6. The trustees made elections under s. 104(13.1) and (13.2). Answer the following questions:

- (a) What amount was the maximum amount available for the trustees to elect under subsections 104(13.1) and (13.2) to be taxed in the trust?
- (b) Why did the trustees elect only \$10,000?
- (c) What would have been the result if they had elected on the maximum amount?
- (d) What would have been the result if they had not made the election?
- (e) Would there be any advantage to reducing other sources of income rather than capital gains?

7. How will the beneficiaries know what amounts and sources of income from the trust to report in their own income tax returns? Note that there are 2 resident beneficiaries and one non-resident beneficiary. Explain the different requirements the trustees must fulfill in respect of the non-resident beneficiary.

8. How might the allocation and designation of income to beneficiaries (see schedule in T3 return) have differed if the Neverland Trust had been created in Grandma Darling's Will?

9. Assume the Neverland Trust document requires the trust to terminate when Lost Boy Two turns 25 years old, and that Lost Boy Two turned 25 in 2009. The trustee, Mary Darling, wound up the trust and distributed all property to the beneficiaries. You learn she has not requested a clearance certificate. What are the potential consequences of Mary failing to request the clearance certificate? What is your advice to her? Explain the reasons for your advice.

## ANSWERS

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1. Filing deadlines for T3's: A trust must file within 90 days of its tax year end. The year end for *inter vivos* trusts is always the calendar year.
  - (a) 90 days after December 31, 2009, or March 31, 2010 - 2010 is not a leap year
  - (b) Same as (a)
  - (c) Depends on choice of year end; no later than 90 days from the first anniversary date of the creation of the trust (based on the date of death) being March 31, 2011. If a year-end is chosen earlier than the first anniversary of death, the deadline will be 90 days after that earlier date.
  - (d) This trust is a tainted testamentary trust, so the rules applying to *inter vivos* trusts will apply respecting the tax rates and year end (i.e. top marginal tax rate and calendar year end). The deadline will be 90 days from December 31, 2010 or March 31, 2011.
  
2. Loss utilisation:
  - (a) The executors should consider making an election under subsection 164(6) to carry back all or a portion of the net capital loss of \$75,000 incurred in the estate to the terminal return where they can be used to reduce income from any source. The losses might be of greater benefit in the terminal return if there are no capital gains in the estate to be offset, or the tax rate in the terminal return is higher than in the trust. Losses carried back from the estate may only be carried back to the year of death – not the prior year.
  - (b) Only losses realised in the first taxation year of the estate may be carried back, so to carry the loss back, the first year end of the estate must take place after the loss.
  
3. How taxation of trusts differ from that of individuals:
  - (a) Year end – a testamentary trust may choose a year end different from the calendar year.
  - (b) Tax rates – an *inter vivos* trust pays tax at the top marginal rate for individuals and is not entitled to any of the rates in the lower brackets.
  - (c) Filing requirements for tax returns – 90 days after year end for a trust.
  - (d) The trustees are required to prepare and sign the tax returns on behalf of a trust.
  - (e) A trust is not entitled to personal tax credits.
  - (f) Income of a trust may not be taxable in the trust if it is allocated to a beneficiary.
  - (g) Requirement for clearance certificate – trustees may request a clearance certificate to protect them from liability upon distribution of trust assets – this is not relevant to taxation of individuals.

4. Purpose of Questions:

- (a) Question 1 – to identify multiple trusts that the Minister may choose to designate as one trust – thereby reducing the number of times one settlor may access the marginal tax rates applicable to testamentary trusts.
- (b) Question 5 – to see if a pre-June 18, 1971 trust should lose its entitlement to the grandfathering provisions. In addition, this may identify whether a testamentary trust is tainted and treated as an *inter vivos* trust not entitled to the marginal tax rates and a choice of year end.
- (c) Question 7 – the terms of the trust respecting income entitlement will determine income of the trust required to be reported by beneficiaries and reported on the T3 slips, the amounts deductible from income by the trust, and amounts available for the specific election by the trustees for such income to be taxed only at the trust level.
- (d) Question 9 - Information about distributions of capital other than cash – this question will identify any relevant issues relating to deemed dispositions on distributions of capital property. Some of these take place at ACB and some at FMV. This question will identify the requirement for the trust to report such dispositions. For example, a distribution to a recipient whose address is not in Canada will be a deemed disposition at FMV – and may also be subject to other tax consequences, including withholding - Part XIII tax, and Part X11.2 tax and other consequences discussed in Chapter 6. The details required if the answer is yes – i.e. ACB to trust and FMV at time of distribution will also provide the information a beneficiary will need when report any subsequent disposition of the property since the amount of proceeds to the trust will also be the acquisition cost to the beneficiary.

5. The \$5,500 was deducted from the other investment income because capital gains and taxable dividends may be of more benefit than income from a trust if their character is designated to the beneficiaries as such. Capital gains, for example, may be offset by capital losses if the beneficiary has any in the current year or has carry forwards available, and the dividend tax credit on the taxable dividends will be available on an allocation of taxable dividends. No specific character is attributed to the flow through of investment income, which is treated as income from a trust with no specific tax benefits. Note: While this type of approach is the most common, every situation should be evaluated carefully. For example, a beneficiary with a Cumulative Net Investment Loss (“CNIL”) may prefer to have interest and taxable dividends allocated if they may use their capital gains exemption.

6. Election to tax income payable to beneficiaries in the trust:

- (a) The maximum is the amount otherwise taxable to beneficiaries – i.e. the amounts paid or payable to beneficiaries being \$95,500.
- (b) An election was made of \$10,000 because this was the maximum amount that could be offset by net capital loss carry forwards available to the trust.
- (c) If the maximum had been elected, the beneficiaries would have no income, and the taxable income of the trust would have been \$85,500, after application of the loss carry forward. This income would be taxed at the top marginal rate for individuals, since this is an *inter vivos* trust.
- (d) If the election had not been made, the beneficiaries would have had an additional \$10,000 in income, the trust would have no income, and the net capital loss carry forward would continue to sit in the trust unused.
- (e) No. Reducing sources of income other than capital gains would not permit the trust to use the net capital loss carry forward since such losses can only be used against capital gains in the trust. Note: there no potential income splitting benefit of having income taxed in the trust because the trust is already taxed at the top marginal rate.

7. The income of the beneficiaries from the trust, including the amounts and their tax character will be reported by the trust on the T3 information return (for resident beneficiaries) or the NR4 information returns (for non-resident beneficiaries) and the relevant amounts for each specific beneficiary will be reported on a T3 Slip or NR4 Slip and mailed to the beneficiary.

8. In this case the trust would have been testamentary and the trust would be taxable at the graduated rates. The trust might elect (see Q#6) to have additional amounts of income taxed in the trust to income split with the beneficiaries – i.e. if the income would be taxed at a lower rate in the trust as compared to the tax rate of each beneficiary.

9. If the trust is subsequently assessed or reassessed for additional tax payable, or there are any unpaid taxes, interest or penalties at the time of the distribution, Mary will have personal liability with respect to the payment of such amounts to CRA. Her liability will be limited to the amount she distributed. You should advise her to apply for the clearance certificate in any event, since this will provide protection from personal liability from any potential future reassessments made after the certificate is issued. In addition, the request may uncover amounts that are owing that Mary was unaware of, giving Mary and opportunity to make arrangements now to have some of the distributed funds returned to pay the tax - the passage of time will make this more difficult. Note: the clearance certificate does not prevent additional assessments or reassessments of the trust, it only protects the trustee from personal liability.

## Chapter Six Review Questions and Answers

### QUESTIONS

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10. Blanche and Blair are brother and sister and last year their father, Mark, passed away. Blanche and Blair are the executors of their father's estate. Since Mark had been making annual payments \$15,000 to each of Blanche and Blair during his lifetime, Blanche and Blair continued to make these payments during the first year after their father's death. The estate had net income of \$48,000 in its first taxation year.

Under the terms of Mark's Will, his estate is to be divided equally between his two children. The estate is immediately distributable and no mention is made of rights to income. Blanche and Blair want to know how the above income is taxed. They understand that generally income of an estate may be taxable in the estate or in the hands of the beneficiary, but they need your advice.

- a) What income must be taxed in Mark's estate and why?
- b) Identify any income for which an option is available to make the income of the first year of the estate taxable to Blair and Blanch.
- c) Explain the requirements for the income you have identified in (b) to be taxable to Blair and Blanche.
- d) List the factors that would be relevant in choosing who is to be taxed on the income over which there is an option.

11. In each of the following situations, identify whether income or capital gains will be taxable to the beneficiary of the trust by stating "yes" or "no." Explain your reasons in each case.

- (a) The net income earned in a qualifying spousal trust.
- (b) Capital gains realized in a trust where the terms of the trust provide that all income is payable to the beneficiaries.
- (c) Under the terms of a discretionary trust the trustees have an absolute discretion to pay all or any part of the income and a power to encroach on capital for the benefit of the beneficiary. The trustee takes steps sufficient to make all amounts of income and capital gains payable to the beneficiaries in the year (signs an irrevocable declaration and sends each beneficiary a copy with a promissory note), but no amounts are paid to any beneficiaries from the trust.

- (d) Income is accumulated for the benefit of a disabled beneficiary where the preferred beneficiary election is made.

12. Identify whether the following amounts are required to be included in income *as a benefit conferred by a trust* under subsection 105(1), indicating “yes” or “no”. Explain why, or why not.

- (a) Amounts required to be paid by a family trust out of the income of the trust for the maintenance of a summer vacation property used by the beneficiaries.
- (b) An interest-free loan to the beneficiary, secured by a mortgage on a home purchased by the trust for use by the beneficiary as a residence.
- (c) Lynn is married to the beneficiary of a trust that owns commercial property. Lynn enjoys free use of the premises which she uses in her business as a retail outlet for designer costume jewellery.

13. Name four differences between the income inclusions for the value of a benefit conferred by a trust under subsection 105(1) and that in respect of an outlay for upkeep of trust property under 105(2).

14. The Flush with Funds trust has just sold shares of a small business corporation that qualify for the capital gains exemption. A capital gain has been realized in the amount of \$2.8 million. There are five beneficiaries of the trust. The following are the circumstances of the beneficiaries:

- (a) A has used all his capital gains exemption.
- (b) B has used \$500,000 of his capital gains exemption.
- (c) C has not used any of her capital gains exemption and has net capital loss carry forwards from previous years of \$60,000.
- (d) D is a non-resident of Canada.
- (e) E has not claimed any capital gains exemption and has a CNIL account the end of the year in the amount of \$100,000 and claimed a \$20,000 allowable investment loss in the prior year.

Assuming that the trustees wish to maximize the use of the capital gains exemption in the hands of each of the beneficiaries, what is the minimum amount that must be paid (or made payable) by the trustees to each beneficiary in order to maximize each beneficiary’s use of the capital gains exemption? Explain briefly. Assume that the trustees allocate and designate the amounts payable. Note that not all details for the answers are in the materials but these are provided in the answers and you are responsible for them.

## ANSWERS

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15. Taxation of income arising in the first year of Mark's Estate.

(a) Generally amounts "paid or payable" are included in income of a beneficiary. The amounts not paid to the beneficiaries must be reported in the income of the estate. Under the Will income is not payable, and during the first year ("executor's year") and during the executor's year distribution of amounts to the beneficiaries are not generally considered legally enforceable.

(b) The only amounts that could be allocated to Blanche or Blair are the amounts actually paid – refer to the general rule above in (a).

(c) Amounts can be taxable to Blanche and Blair only if the executors allocate these amounts as taxable to the beneficiaries. Should either Blair or Blanche object to having income allocated to them for tax purposes during the executor's year, CRA will permit all the income to be taxed in the trust notwithstanding the fact that it was paid to a beneficiary – this will not technically be an issue here since Blair and Blanche are the executors and the beneficiaries.

(d) In determining whether to allocate the amounts to Blanche and Blair and designate the character of the payments the following factors are relevant:

- the relevant tax rates of Blair and Blanche as compared to that of the estate – all are taxed at the marginal rates, so this will depend on the level of income for each – i.e. there may be an opportunity for income splitting between the estate and the beneficiaries
- the ability of the beneficiaries to offset taxable capital gains with allowable capital losses or net capital loss carry forwards of prior years
- the use of any non-refundable tax credits such as the dividend tax credit

16. Identify the situations where there is an income inclusion to the beneficiary (some of these questions rely on material from previous chapters).

- (a) Yes. One of the terms of a qualifying spousal trust is that all income (often referred to as net income) must be payable to the spouse beneficiary during his or her lifetime. Accordingly the income in such a trust will be taxable to the spouse/beneficiary.
  - (b) No. Capital gains are not considered to be income for trust law purposes. Accordingly, a requirement that the income be payable to a beneficiary in the trust document does not make capital gains payable. Accordingly, such amounts would not be taxable to the beneficiary based on the information given. Note: this would be different if the trust also provided that capital gains were payable.
  - (c) Yes. As long as the beneficiaries have a legal right to enforce payment of the amounts for which the executors exercise their discretion, then the amounts will be taxable in the beneficiaries' hands. Generally in order to make the payments legally enforceable, the steps listed in paragraph 6.1.5 should be taken. At the very least there should be a written irrevocable decision of the trustees making such amounts payable to the beneficiaries under the exercise of their discretion given in the trust document.
  - (d) Yes. Income subject to a preferred beneficiary election would be taxable in the beneficiaries' hands even though it is not paid or payable to the beneficiary in the year. See 4.9.
17. Identify where there is an income inclusion as a benefit conferred by a trust under 105(1).
- (a) No. This is taxable to the beneficiary under 105(2) as income in the form of an outlay for upkeep of trust property under the terms of the trust. Note: The income inclusion of a benefit conferred by a trust under 105(1) specifically excludes amounts required to be included in income under 105(2).
  - (b) No. This is similar to *Cooper v. MNR* in which the interest-free loan was held not to be a benefit under 105(1).
  - (c) Yes. This would be a benefit under 105(1) whether Lynn is a beneficiary or not. The recipient of the benefit conferred by a trust need not be a beneficiary in order for it to be taxable. The use of the property is not for personal use and will not fall within CRA's administrative concession – see 6.2.
18. Contrast the requirements for income inclusion under 105(1) as a benefit conferred by a trust, with that under 105(2) as an amount in respect of upkeep or maintenance of property.

- (a) The benefit conferred by a trust under 105(1) can be taxable to any person who receives the benefit. Only a beneficiary can be taxable under subsection 105(2).
- (b) There is no deduction permitted from trust income in respect of the amount included in the recipient's income under benefit provision in 105(1). A deduction is available to the trust for amounts paid out of income taxable to a beneficiary under 105(2).
- (c) The benefit conferred under 105(1) can be paid out of income or capital of the trust. Under 105(2), the amount paid to the beneficiary must be out of income. Note: 105(2) is an attempt to prevent avoiding the income of a trust being received directly or indirectly by a beneficiary without taxation to that beneficiary.
- (d) Taxation under 105(2) for receipt of income for the upkeep of trust property only applies if the payment is mandatory under the terms of the trust. There is no such requirement in 105(1).

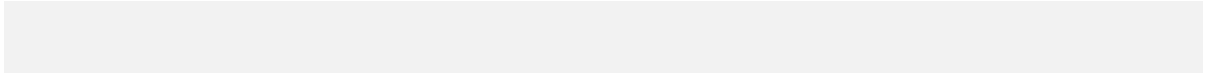
19. Maximum amount to be paid to each beneficiary to maximise use of the capital gains exemption.

- (a) Nil since no exemption is available.
- (b) \$125,000 - \$250,000 of the exemption is still available and the trust need only pay the taxable portion.
- (c) \$435,000 of which \$60,000 will be off-set by the net capital loss carry forward and the remaining amount will be eligible for the full capital gains deduction of \$375,000. (C must utilise the her net capital loss carry forwards to reduce capital gains in the year if she is to maximise her use of the capital gains exemption.)
- (d) Nil – a non-resident is not eligible for the capital gains exemption.

NOTE: The materials in this course generally apply only to residents of Canada except where otherwise specifically noted. This question should therefore alert the student to the possibility that a non-resident may be treated differently from other beneficiaries. In fact, non-residents of Canada are not eligible for the capital gains exemption.

- (e) \$475,000. Only allowable business investment losses claimed in the current year reduce access to the deduction. The CNIL balance will reduce the amount of gain available for the deduction.

Note: Only the taxable portion of the capital gain need be paid to a beneficiary. Thus the maximum amount payable would be the maximum amount that can be offset by the capital gains “deduction” in the year. The lifetime limit for the capital gains “exemption” is \$750,000. The capital gains “deduction” refers to the amount available to reduce the taxable portion of eligible capital gains included in income (a lifetime limit of \$375,000 for the capital gains deduction).



## Chapter Seven Review Questions and Answers

### QUESTIONS

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20. Indicate whether the following statements are True or False, followed by a brief explanation for your answer.
- (a) Minimum tax is not relevant in the year of death.
  - (b) A rollover is available with respect to capital property transferred to a testamentary discretionary trust where the sole beneficiary is the settlor's spouse or common-law partner during his or her lifetime.
  - (c) In the absence of an election to defer the payment of tax, the due date for paying taxes for the year of death is either April 30<sup>th</sup> of the year following death or 6 months after the date of death if death occurs after November 30<sup>th</sup>.
  - (d) A deemed disposition on death of depreciable property could result in a capital gain or a capital loss in respect of the property.
  - (e) A donation tax credit in the year of death is calculated on the higher of the following amounts: the eligible amount of gifts to qualified charitable donees and 100% of the net income of the deceased.
21. In addition to the T1 terminal return, what other returns may be filed in respect of the year of death? What are the benefits of filing such additional returns?
22. Identify whether or not each of the following amounts will be taxable in the tax return of the deceased in the year of death by indicating "yes" or "no."
- (a) A death benefit of \$12,000 paid by the deceased's employer to the executor of the estate in recognition of the employee's service.
  - (b) The value of the RRSP of the deceased at the date of death where the deceased has named his brother as the beneficiary.
  - (c) Income in respect of a periodic payment not due or received at the date of death but due after death but before the end of the calendar year of death.
  - (d) Dividends declared as payable but unpaid as of the date of death.
23. You are the executor of the Easy estate. The deceased had only employment income and you have filed his T1 return for the year of death including all the income on the T4 supplied by his employer for employment income up to the time of death. After payment of funeral expenses and all other expenses of administering the estate, the only asset is a balance of \$67,000 in the estate bank account. You have filed the terminal return, paid the tax owing, and Canada

Revenue Agency has issued a Notice of Assessment showing no additional taxes payable. You have the Notices of Assessment for the 3 taxation years prior to death which you found among Mr. Easy's personal papers, all showing no amounts owing. Mr. Easy's daughter, Beth, would like to receive an immediate distribution of the \$67,000 remaining in the estate account. What is the risk you take if you distribute the remaining funds without a Clearance Certificate?

24. Identify whether a rollover is available in each of the following circumstances by indicating "yes" or "no." Briefly explain your answer.

- (a) Where the beneficiary of the registered plan is a qualifying spousal trust.
- (b) Where a financially dependent adult child is the beneficiary.
- (c) Where the beneficiary is the spouse or common-law partner of the deceased.
- (d) Where the plan proceeds are transferred to a lifetime benefit trust.

25. Explain the unique treatment of capital losses realised, or deemed to be realised by the deceased in the year of death.

26. Identify and explain four rollovers the executor can elect out of on death in order to fully utilize either the capital gains exemption or capital losses in the year of death.

## ANSWERS

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27. True or False with a brief explanation:

- (a) False. While an individual has no minimum tax for the year of death, minimum tax credits from prior years may be used to off-set income tax payable in respect of the year of death.
- (b) False. A qualifying spousal trust must not be discretionary with respect to income. Note: if the spousal trust is testamentary, the terms of the trust must be set out in the Will of the deceased if it is to qualify for the rollover.
- (c) False. The payment is due 6 months after death if the death occurs after October 31<sup>st</sup>. See 7.4.
- (d) False. While it is possible to have a capital gain in respect of depreciable property, if the deemed proceeds exceed the original cost of the property, it is not possible to have a capital loss since a loss on depreciable property is a terminal loss which is fully deductible from income.
- (e) False. It is the lower of these two amounts that limits the amount for the purpose of the calculation of the credit. In addition, donation amounts not claimed in any of the 5 years prior to death may be utilized in calculating the eligible amount of

gifts. Note that the donation tax credit is not the lower amount, but the calculation of the credit is based on the lower amount – clarifying 7.13.3.

28. A separate return may be filed in respect of:

- (a) rights and things - certain amounts that have been earned prior to death, and are due but are unpaid at the date of death, and would have been included in income of the deceased upon receipt
- (b) stub period income for the year from a testamentary trust if the taxation year of the testamentary trust ended at a time in the calendar year before death.

Note: In rare circumstances an additional return is available for stub period income from a partnership or sole proprietorship grandfathered partnership under rules otherwise requiring a calendar year end.

The benefits of filing separate returns are that they:

- (c) provide additional access to the marginal rates of tax; and
- (d) permit access to multiple personal credits, i.e. the basic personal amount, the age amount, the spouse or common-law partner amount and the amount for an eligible dependant, or the amount for infirm dependants age 18 or older and the caregiver amount.

29. Yes or no with a brief explanation:

- (a) No. Only the amount in excess of \$10,000 would be taxable, and it is taxable in the income of the estate, not the terminal return.
- (b) Yes. The entire amount will be included in the income of the deceased for the year of death.
- (c) No. Only the portion of the income in respect of any periodic payment that accrues up to the date of death will be included in the income of the deceased.
- (d) Yes. These must be included and may be reported in the rights and things return.

30. An executor risks personal liability for the amount of any taxes owing in the event funds are distributed without a Clearance Certificate. Although CRA has already assessed Mr. Easy for all taxation years including the year of death, a reassessment could be received within the period for reassessment. A subsequent reassessment for a period prior to the distribution without a Clearance Certificate could result in personal liability for the amount of any tax, interest and penalties owing on a reassessment. If a reassessment takes place and the Clearance Certificate

has been issued, although the amount will still be owing by the estate, the executor will not have any personal liability. While the executor may have a legal right to ask the beneficiary to indemnify him or her in the event that CRA subsequently reassesses the estate, the executor may not wish to take the risk that the beneficiary will honour such indemnity without litigation.

31. Yes or no with a brief explanation:

- (a) No. A rollover is not available where the beneficiary is a trust for a surviving spouse except in limited circumstances (unless the spouse is mentally infirm and the proceeds are transferred to a lifetime benefit trust - see 7.8.4).
- (b) No. A rollover is not available. Where the beneficiary of the plan is a financially dependent adult child, the legal representative may make a deduction from the terminal return (see 7.8.2) and the proceeds will be taxable in the hands of the adult child. However, in order for the rollover to be available, the financially dependent adult child (i.e. over age 18) must be dependent on the deceased annuitant *by reason of physical or mental infirmity* (see 7.8.3).
- (c) Yes, a rollover is available where the beneficiary contributes the proceeds of the plan to his or her own plan.
- (d) Yes. A rollover is available where the proceeds of the plan are payable to a lifetime benefit trust which uses the proceeds to purchase a qualified annuity for the benefit of a mentally infirm child of the deceased who was dependant on the deceased because of mental infirmity. See 7.8.4.

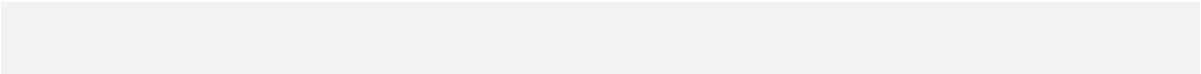
32. Capital losses realized or deemed to be realised in the year of death, including capital losses resulting from the deemed disposition on death, and any unused net capital loss carry forward from any prior years, are eligible to reduce all sources of income in the year of death and the prior year. Allowable capital losses and taxable capital gains in the year of death must first be offset against each other. Any net taxable capital loss remaining, and any net capital loss carry forwards from other years, must be applied first to reduce the income in the year of death to nil. If any amount is still remaining, the balance may be applied to other sources of income in the year immediately preceding death.

33. The following list of rollovers, although not exhaustive, could be elected out of in order to create income eligible for the capital gains exemption or the use of losses in the year of death or the preceding year:

- (a) A spousal rollover for any capital property.
- (b) A spousal rollover for capital property that qualifies for the capital gains exemption.
- (c) A refund of premiums in respect of an RRSP or RRIF.

(d) The inter-generational rollover of qualifying farm property.

Note: where capital property qualifies for a rollover, an election out of the rollover would increase or “bump up” the cost of the property to the recipient beneficiary.



## Chapter Eight Review Questions and Answers

### QUESTIONS

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34. State whether the following are True or False. No explanation is required. However for study purposes some explanations are given in the answers.
- (a) The personal representative may elect to file a separate tax return for the year of death for “stub period income” of a testamentary trust where the taxation year of the trust falls in the calendar year of death and before the date of death.
  - (b) Charitable donations made pursuant to a gift in the Will may be utilized in the terminal return.
  - (c) Net capital loss carry forwards must be used to reduce income from any source in the year of death to nil before they can be used to reduce income in the year immediately preceding death.
  - (d) As a rule of thumb, it is always best to minimize tax in the year of death.
  - (e) If capital property diminishes in value within a year after death the unrealised loss may be carried back to the terminal return under the provisions of subsection 164(6).
  - (f) A redemption or repurchase by a private corporation of shares at fair market value within the 12 months following death creates a capital loss that can be carried back to the terminal return, effectively converting a capital gain in the terminal return into a deemed dividend in the estate.
  - (g) The tax planning strategy often referred to as the “pipeline strategy” permits a tax-free distribution of assets in a corporation where the assets already have a high cost base.
35. List 8 reasons why a personal representative may make elections to maximize income in the year of death.
36. What is the effect of an election out of the rollover available on distribution of capital property by a trust to a beneficiary on a future disposition of the property by the beneficiary?
37. In the example of Ration Crash at 8.3.1, if the net capital loss carryforward of \$40,000 exceeded the income in the year of death, Sandra could increase the income in the year of death to utilize the loss by the strategies mentioned in the material – e.g. by electing out of the spousal rollover on the RRIF, and/or electing out of the rollover on the Whistler property (on the

assumption that the principal residence exemption will be used on the Burnaby property). What other option to utilize the loss is available?

38. Where the assets of an estate are to be distributed in specific shares amongst beneficiaries, difficulties may arise where the distribution consists of assets other than cash. Explain how a distribution of assets in kind may affect the division of property among beneficiaries.

39. What type of property held by a private corporation is eligible for the 88(1)(d) bump on a winding up as a result of the sale of the shares of the corporation to a holding company followed by a winding-up of a subsidiary?

40. Explain why there is double tax on death on shares held in a private corporation.

## ANSWERS

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41.

- (a) True.
- (b) True.
- (c) True.
- (d) False.
- (e) False. There must be a disposition, a mere decrease in value is not sufficient. In addition the loss must be incurred in the first taxation year of the estate not just within the year after death.
- (f) False. At first blush the statement appears to be true, but the repurchase of shares which creates the loss must take place within the first taxation year of the estate, not the first 12 months after death. Therefore, the statement is not true as it was presented.
- (g) True.

42. Eight reasons to increase income in the year of death:

- (a) Where income may be taxed in the lower rate in the terminal return because the deceased had little or no income in the year of death – this may occur, for example, if the death takes place early in the calendar year.
- (b) To use minimum tax credits carried forward from previous years.
- (c) To utilize loss carry from previous years

- (d) To use losses in the current year
- (e) To trigger capital gains are eligible for any portion of the deceased person's unused capital gains exemption.
- (f) To make use of personal tax credits available in the terminal return.
- (g) To make use of unused dividend tax credits.
- (h) To take advantage of any unused donations available in the terminal return.

43. An election out of a rollover, such as the spousal rollover, deems the proceeds of disposition to be fair market value, and the corresponding ACB of the property to the transferee (the estate in the case of death or to the beneficiary in the case of a distribution of trust or estate property) is "bumped up" to fair market value in the case of a gain, or "ground down" to the lower fair market value if there is an unrealised loss on the property. The transferee will calculate any gain or loss on a subsequent disposition, reducing a future gain, or increasing a future loss.

44. Sandra, as the personal representative, could consider using the unused net capital losses against any income reported in the year immediately preceding Ration's death. However, the income in the year of death must be fully exhausted before an additional carry back to the preceding year may be made.

45. The value of property distributed in kind should take into account the tax attributes. For example, if the tax cost of property is not equal to the fair market value, it may not be fair to distribute or to divide assets among beneficiaries based purely on the fair market value at the time of distribution. For example, an asset with a value of \$100,000 but an ACB of \$50,000 does not have the same value in the beneficiaries' hands as an amount of \$100,000 in cash since the latent tax liability must be paid on a future sale of the asset. Accordingly, a discount may be appropriate in determining the value of property distributed in kind that has an unrealized capital gain when the personal representatives are deciding how to divide the assets among beneficiaries. Note: there is no "formula" for deciding if there should be a discount, or determining the amount, if any, and the division and distribution of trust property among beneficiaries entails many legal issues is not covered in this material.

46. The bump is available for non-depreciable capital property which would include land that is capital property (not including buildings), and shares of other corporations.

47. There is a deemed disposition at fair market value of the shares of the corporation and the cost to the estate of the shares is equal to that FMV. However, there is no corresponding adjustment in the cost of the underlying assets of the corporation. For example, if the corporation

owns a single asset with a fair market value of \$500,000 and an ACB of \$400,000, the shares will be deemed disposed of on death for \$500,000 and may be distributed by the estate to a beneficiary who will receive them with an ACB equal to the fair market value on death being \$500,000. However, the asset in the corporation still has a tax cost of \$400,000. Sophisticated tax planning following death is needed to reduce the impact of such double tax.