

Chapter Nine Review Questions and Answers

QUESTIONS

1. True or False:
 - (a) The attribution rules will apply to a sale of capital property from one spouse to the other for proceeds of disposition equal to fair market value.
 - (b) The attribution rules prevent an individual from transferring property to shift income to certain related persons by attributing income from the property back to the transferor.
 - (c) Where a transfer from one individual to another will attract the attribution rule, a transfer to a trust for the benefit of such a person will also attract the attribution rule.
 - (d) A transfer to a trust for the benefit of a related person under the age of 18 will attract attribution of income and capital gains back to the transferor.
 - (e) If a settlor is the sole trustee of a discretionary trust, the settlor will be subject to attribution of income and capital gains paid or payable to a related beneficiary who is under the age of 18 but no attribution will apply if the beneficiary is age 18 or over.
 - (f) Where the attribution rules apply to the transfer of property, attribution will cease when the property is sold.
 - (g) The kiddie tax on split income will only apply to dividends of a private corporation where the attribution rules do not otherwise apply.
 - (h) Attribution rules do not apply to transfers to testamentary trusts.

2. Generally the attribution rules apply where transfers are made to or for the benefit of persons in a particular relationship to the transferor. What relationships will attract the attribution rules?

3. Donald wishes to set up a discretionary family trust for his three nephews, Huey, Dewey and Louie, ages 8, 10 and 13 respectively (“HDL”). He settles the Duck Family Trust and transfers \$200,000 in cash to be invested in mutual funds, and signs a trust agreement, appointing himself and his wife, Daisy as co-trustees. Under the agreement, payments of income to HDL are at the absolute discretion of the trustees and there is a power to encroach on capital for their benefit. Uncle Howard, Donald’s brother, also contributes \$200,000 to the trust.

Describe the effect of the attribution rules as they apply to Howard and to Donald in this fact situation and suggest strategies that are available, if any, to avoid such attribution rules.

4. List the unique features of the so called “settlor attribution rule” under 75(2).
5. In what unique circumstances might it be advantageous to argue that the attribution rule in subsection 75(2) is applicable?
6. Oleg and Lyudmila have come to you for tax advice. Oleg has just inherited \$1,000,000 from his grandmother and he and Lyudmila would like to explore ways in which they can use the inheritance to income split with other family members. Lyudmila’s mother, Helen, is unwell and is in a private nursing home that costs \$5,500 per month. While Helen’s CPP and Old Age Security benefits defray the cost of the nursing home, Oleg and Lyudmila are funding the additional costs. They have two children, a daughter age 12 and a son, age 18 who is just starting university. Identify some income splitting opportunities for Oleg and Lyudmila and explain briefly how each works. Do not address income splitting as between Oleg and Lyudmila. Include income splitting using trusts and/or loans in your answer.
7. Oleg has just told you that he also stands to inherit substantial amounts from his parents as well. What income splitting strategies for Oleg and his family might Oleg’s parents implement as part of their estate planning? Briefly explain how each opportunity works and the trade-off(s) that should be considered.
8. Explain how a loan at prescribed rates made at a time when interest rates were at a historically low rate could produce significant tax savings in the future.

ANSWERS

1.
 - (a) True. If the sale is at fair market value, the transferor spouse must also elect out of the spousal rollover if the attribution rules are to be avoided.
 - (b) True.
 - (c) True. See 9.2.3.
 - (d) False. Such a transfer will not attract the attribution of capital gains but attribution on other types of income will apply.
 - (e) False. Subsection 75(2) applies because the settlor is the sole trustee of a discretionary trust. The age of the beneficiaries is not relevant. Note: see 9.3.2 – text should read:

If the settlor is the sole trustee, the rule may apply in any event, even if the trust is **not** discretionary, because as sole trustee, the settlor would have the sole authority to dispose of trust property – see paragraph 75(2)(b).

- (f) False. There are rules that continue the application of the attribution rule in respect of the proceeds of sale of transferred property and substituted property. See 9.2.6.
- (g) True.
- (h) True. The settlor is deceased.

2. Transfers to or for the benefit of the following persons will attract the attribution rules:

- (a) A spouse or common-law partner.
- (b) A related child under the age of 18 years of age.
- (c) A niece or nephew of the transferor under the age of 18.
- (d) One's self – i.e. 75(2).

3. The Duck Family Trust:

(a) Uncle Howard: He is either HDL's father or uncle. Thus attribution of income (not capital gains) applies for any year before they attain age 18. Note: no alternate strategy might be a loan for prescribed rates, or Uncle Howard might consider contributing to an RESP for the benefit of HDL in lieu of the transfer to the trust, although the dollar limits would be exceeded.

(b) Donald. Subsection 75(2) applies since Donald is one of two trustees and the trust is discretionary. The income from any property transferred to the trust by Donald or any property substituted for such property will attract attribution of income and capital gains throughout Donald's lifetime whether or not HDL attain age 18. In addition, if property is distributed from the trust during his lifetime, no rollover of a distribution in kind to a beneficiary is available. An alternate strategy would be for Donald not to be a trustee of the trust or, alternatively, for Donald and two other persons who are not settlors of the trust (i.e. not Uncle Howard but perhaps Daisy, and the nephew's mother Della, Donald's sister) to be trustees with a majority clause such that any two of the three trustees may make decisions. In this way, Donald would not have sufficient control over disposition of trust property or distribution of trust property for subsection 75(2) to apply. However, there will still be attribution of income other than capital gains for any year HDL have not attained age 18, and for alternates to that rule see a) above for Howard.

4. Unique features of the settlor attribution rule in subsection 75(2):
 - (a) The rule applies even if a transfer is made at fair market value.
 - (b) The rule applies regardless of the relationship between the transferor or settlor and the beneficiary.
 - (c) During the lifetime of the settlor, there will be no rollover of capital property distributed to any beneficiary.
 - (d) The application of the attribution rule in subsection 75(2) is the only situation in which losses are flowed through a trust to another person since not only income but losses are also attributed to the settlor. See 9.3.6 and 9.3.

5. Where losses are trapped in the trust – preferred answer. (However there may also be some advantage in the rare case where income will be taxed more favourably in the hands of the settlor because of the settlor’s marginal rates (the trust will be *inter vivos* and taxed at the top rate) or for other reasons such as losses of the settlor.) Note that where the rule in subsection 75(2) applies it is not a year by year option – rather attribution continues throughout the lifetime of the settlor.

6. Income splitting with children, grandchildren and parents:
 - (a) A discretionary trust for the benefit of the children will not attract any attribution in respect of their 18 year old son, nor there be any attribution of capital gains in respect of their daughter.
 - (b) A family trust funded by a loan at the prescribed rates may permit income splitting with their daughter, and if set up as a family trust, may permit income splitting with future issue – i.e. grandchildren even if they are under age 18.
 - (c) An “age 40” trust for the children could be used to income split as noted above with the additional option to accumulate amounts in respect of
 - (i) income for any child between 18 and 21, and
 - (ii) capital gains for any child who has not attained age 21.
 - (d) Gift to Helen – no attribution because she is an adult even though she is related to Oleg - so she can use investment income to pay cost of nursing home in cheaper after-tax dollars
 - (e) Gift to the 18 year old son - no attribution since he is an adult - so he can use investment income to pay education expenses in cheaper after-tax dollars
 - (f) A trust for the benefit of Lyudmila’s mother Helen funded by a gift – using the investment income to fund the nursing expenses with pre-tax dollars achieving income splitting. Income paid to Helen from the trust will be taxed at her marginal rates, and the use of a trust will allow for a degree of control over the capital and permit Oleg to made a gift over of any unused capital after Helen’s

death to another family member – such as Lyudmila, or their children. Watch rule in subsection 75(2)

- (g) Note - a loan to Helen or 18 year-old or a trust for either of them would attract the attribution rules if it were made for the purpose of reducing income under - see 9.2.5.

7. Oleg's parents could set up testamentary trusts in their Wills as follows:

- (a) Multiple trusts in his parent's Wills could be set up for individual beneficiaries: i.e. each of Oleg, Lyudmila (if his parents were comfortable with this), each of Oleg and Lyudmila's children, and each grandchild. Note – the beneficiary does not have to be in existence when the Will is drafted, or even on the death of the testator as long as it is clear that there is a time and method for identifying the beneficiary– i.e. certainty of object and the rule against perpetuities is not offended.
- (b) A discretionary family trust could be set up in his parents' Wills whereby income could be sprinkled among Oleg and other family members.
- (c) In (a) there would be multiple access to the marginal rates of tax in each testamentary trust but no flexibility with respect to distributing income or capital among a group of beneficiaries. In (b), income and capital can be distributed on a discretionary basis to the family members in the group who are in the lower tax brackets, or according to their particular life circumstances with flexibility to assign all income or capital to one or more beneficiaries to the exclusion of one or more.
- (d) Income splitting opportunities may be doubled if each of Oleg's parents creates testamentary trusts as noted above. See 9.5.8.

8. Loans at prescribed rates permit income splitting with respect to any income earned in excess of the prescribed rate. Accordingly, if rates of return on the principal exceed the prescribed rate of interest that must be paid on the loan, significant savings may be realized. For example, if the prescribed rate is 3% and a loan is made at the prescribed rate and subsequently a rate of return of 6% is earned by the borrower, income splitting will be achieved on the spread between the rate of return and the prescribed rate. The prescribed rate at which the loan is made need not be adjusted at a subsequent time when prescribed interest rates increase.

Chapter Ten Review Questions and Answers

QUESTIONS

9. True or False:
- (a) For tax purposes capital gains may be taxable in the hands of a beneficiary even where they are not paid or payable in the year but rather accumulated in a discretionary trust for the benefit of a beneficiary who is under age 21 provided the right to the amount accumulated is payable no later than the beneficiary's 40th birthday.
 - (b) Fixed interest age 40 trusts, in order to income split with accumulating income, must be drafted to ensure that identity of the beneficiary and the amount of the beneficiary's entitlement is ascertainable in the current year.
 - (c) Since income and capital gains in an age 40 trust may only be accumulated in respect of beneficiaries who are under age 21 in the year the income or capital gains are earned, there may be discretion with respect to allocations of income and capital to beneficiaries who have attained age 21 in the year.
 - (d) An estate freeze is an effective way to effect an immediate transfer of wealth to other family members.
 - (e) It is possible to avoid the attribution rules and the kiddie tax on dividend income from a private corporation if the trust borrows at commercial rates from a financial institution or arm's length person and uses the borrowed funds to subscribe for treasury shares.
 - (f) In the course of an estate freeze, the corporate attribution rule may apply unless the corporation qualifies as a small business corporation.
10. Identify two strategies whereby income and capital gains of a trust not otherwise subject to the attribution rules may be taxed in the hands of a beneficiary without amounts being paid or payable to such beneficiary in the current year?
11. List three rollovers that are available in respect of property passing on death to a child of the deceased.
12. List three rollovers that are available in respect of property passing on death to the spouse or common-law partner of the deceased

13. Identify whether each of the following terms in a qualifying spousal trust are Mandatory, Optional or Not Permissible. Give brief reasons for your answer.
- (a) Requirement that all income is payable to the surviving spouse
 - (b) Requirement that net capital gains be payable to the spouse.
 - (c) Entitlement to income may cease upon remarriage or cohabitation of the spouse.
 - (d) The right to encroach on capital is terminated in the event the surviving spouse remarries.
 - (e) A right to encroach on capital for the benefit of a dependent child.
 - (f) There is an unrestricted right for the trust to lend.
14. Explain a floating trust. In what circumstances might a floating trust be appropriate?
15. Explain how an estate freeze saves income tax and probate fees on death.
16. In an estate freeze where the freezor transfers property to a corporation in exchange for preference shares, why must the rights to dividends be restricted? What restrictions must there be on the dividends of shares taken back from a corporation in an estate freeze?
17. What terms must be included in the family trust that holds the common shares resulting from an estate freeze where there is a risk that the corporation may not qualify as a small business corporation?
18. List the factors that should be considered in determining whether a business owner should carry out an estate freeze.

ANSWERS

19. True and False
- (a) False. The right to the capital gain cannot be subject to the exercise of any discretion - even if there is an exercise of discretion that make the right vested.
 - (b) True. Note: without the exercise of any discretion.
 - (c) True.
 - (d) False. It is only the future growth that can be transferred through an estate freeze so that there is no immediate transfer of wealth.
 - (e) False. Although the attribution rules may be avoided, the kiddie tax will apply on dividends paid by a private corporation to beneficiaries under age 18. See 10.6.10, 9.3.6.
 - (f) True. See 10.6.11.

20. Where income not paid or payable can be taxed in the hands of the beneficiary:
- (a) Where a preferred beneficiary election is made for a disabled beneficiary.
 - (b) Where capital gains or income are accumulated for the benefit of a beneficiary who is under age 21 in a fixed interest age 40 trust that complies with the requirements in the Act (under subsection 104(18)). See 10.2.2 and 4.5.11.

Note another possible answer, not expected here, is where the trust requires amounts to be paid out of income for upkeep and maintenance of property under subsection 105(1).

21. Rollovers to a child on death:
- (a) Inter-generational rollover of interest in farm and fishing property.
 - (b) Rollover of an RRSP or RRIF to a trust for a mentally infirm child.
 - (c) Rollover of an RRSP or RRIF to a financially dependent child under the age of 18.

22. Rollovers to a spouse on death:
- (a) Capital property that is transferred to a surviving spouse or common-law partner.
 - (b) Capital property transferred to a qualifying spousal trust.
 - (c) Rollover of an RRSP or RRIF to a spouse or common-law partner.

23. Terms in a qualifying spousal trust:
- (a) Mandatory
 - (b) Optional.
 - (c) Not permitted.
 - (d) Optional. There is no requirement for a right to capital. Note that no one else may have a right to capital during the lifetime of the spouse.
 - (e) Not Permitted. No one other than the spouse may be entitled to income or capital during the lifetime of the spouse.
 - (f) Not permitted. The right to lend should be restricted. See 10.4.1.

24. A floating trust is a trust created under the terms of a Will whereby the amount of the estate utilized to fund the trust is at the discretion of the executors. Thus a trust may be set up with a nominal amount, say \$1.00 and “such additional amounts as the executors determine in their absolute discretion.” These trusts are appropriate where the testator is not certain whether

or not such a trust is appropriate. For example, if the estate is small, there may be no tax advantage to such a trust.

25. In a typical estate freeze the owner or “freezor” exchanges property for fixed value preference shares. The growth shares, in the form of new common shares, are issued to other family members or a trust for their benefit. These transactions limit the value of the assets owned by the freezor to the value at the time the freeze takes place. Any subsequent increase in the value of the corporation will not be reflected in the value of the fixed value preference shares held by the freezor. Thus on death, the post freeze gain will not be owned by the freezor and will not be included in the terminal return. In addition, since the value of the assets passing under the Will is reduced, there will be a reduction in probate fees in provinces where applicable.

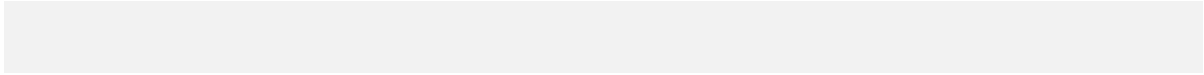
26. If the amount of dividends that may be declared by the board of directors is unlimited, the value of the shares may be more than the “fixed value” enshrined in the redemption amount since there is a potential at any time that a large dividend may be declared on the shares. Accordingly, the dividends must be subject to a fixed or maximum annual rate. In addition, where the fixed or an annual dividend is not declared by the corporation, the dividend right for that annual dividend must not be preserved for future years – i.e. the right is not cumulative.

27. During the lifetime of the freezor, neither the spouse of the freezor nor any beneficiary who is a related person under the age of 18 or a niece and nephew under the age of 18, may receive any income or capital from the trust. Without this term the corporate attribution rule may apply to deem income to the freezor. See 10.6.11.

28. There are many factors in determining whether an estate freeze is appropriate for a business owner and every situation is unique. The factors are not all identified or fully explored in these materials since this is only an introduction to estate planning. However the factors may include:

- (a) The age of the business owner - if very young it may be too soon.
- (b) The current value of the business – is the value enough for the owner’s future needs?
- (c) The family situation of the owner – are there heirs apparent to the business?
- (d) The nature of the business – will there be growth?
- (e) Whether the business owner is “ready” and “willing” to transfer the entire future increase in value.
- (f) Tolerance for complexity.
- (g) Comfort level of the business owner with loss of complete autonomy with respect to the control and management of the corporation.

- (h) Ability of the business owner to secure his wealth in the business so it is protected from unknown future events such as a falling out with new owners and/or a collapse in value.



Chapter Eleven Review Questions and Answers

QUESTIONS

29. True or False:
- (a) A taxpayer who fails to file the required income tax return by the due date will be liable to a penalty of 5% of the amount of the tax liability for the taxation year.
 - (b) Where interest is assessed in respect of unpaid taxes, the taxpayer may deduct such interest from income.
 - (c) The relationship between the taxpayer and a professional advisor is privileged and the advisor cannot be compelled to disclose information provided by the taxpayer for the purpose of obtaining tax advice.
 - (d) A search warrant may be issued permitting CRA to enter and search any building or place where CRA has reasonable and probable grounds to believe that evidence of an offence under the Act may be located.
 - (e) A taxpayer's goods and chattels may be seized if the taxpayer is engaged in tax evasion.
 - (f) Individuals other than trusts may be required to make instalment payments of tax.
 - (g) The taxpayer has a right to refuse to permit CRA to inspect, audit and examine books and records unless CRA obtains a search warrant.
30. Briefly describe the role of each of the following as it relates to Canada's system of income tax:
- (a) the Department of Finance.
 - (b) Canada Revenue Agency.
 - (c) the taxpayer.
31. The executors of Mr. Ranger have applied for a Clearance Certificate prior to distributing the residue of the estate to the beneficiaries. As a result, CRA has conducted an audit and has reassessed Mr. Ranger for the last 5 taxation years prior to death. The executors have come to you for advice regarding appealing these assessments.
- (a) What would you advise the executors regarding the validity of the assessments?
 - (b) What formal steps need to be taken to preserve the right of the executors to appeal the assessments?
 - (c) What are the deadlines for taking any action? Provide details.

32. The CRA collections department is now demanding payment of the amounts reassessed in respect of Mr. Ranger. Assume the reassessments are under appeal.

- (a) What are your options with respect to payments of the amounts reassessed?
- (b) State the consequences of each of these options under the Act depending whether an appeal is successful or unsuccessful.

33. What would be the consequences to the executors had the reassessments taken place after a distribution of the residue of the estate if the executors had not obtained a Clearance Certificate?

34. Fred passed away in 2008 and his widow, Fran, is the executor of the estate. She has recently discovered that Fred had an off-shore investment account that was used to hold unreported cash receipts from Fred's handyman business which operated as a sole proprietorship. These funds accumulated over a number of years and currently there is \$350,000 in the account. The income from Fred's handyman activities was never reported on Fred's tax returns, nor was any of the investment income earned in the off-shore account. You are the advisor to Fran as the executor of the estate. She asks for your advice. What do you recommend? Give reasons.

35. Assume Fran decides not to accept your advice and wishes you to prepare the request for a Clearance Certificate. What should you do?

36. Identify whether each of the following situations may be considered tax evasion by indicating "yes," "no," or "maybe," and briefly give reasons.

- (a) Transferring a large amount of cash to an investment account in the name of a parent to reduce the rate of tax on the investment income.
- (b) Omitting to report investment income as a result of a careless mistake.
- (c) Hiding income in an offshore account and not reporting it.
- (d) Engaging in an aggressive tax planning strategy that CRA has attacked in the past but which has not been the subject of any ruling by a Court, and only after obtaining professional advice that CRA's position may not be correct under the law.
- (e) Making a large RRSP contribution in order to generate a large refund in the year in which the taxpayer had a balloon income receipt.

ANSWERS

37. True/False

- (a) False. It is 5% of the *unpaid* tax owing. Note - there is an additional penalty of 1% of any *unpaid tax* for every month the return is filed late, not exceeding 12 months.
- (b) False. However, interest paid on refunds must be included in income.
- (c) False. While all professional advisors have a duty of confidentiality, only solicitors may refuse to disclose information to CRA on the basis of privilege. Solicitor and client privilege is specifically provided for in the Act but this does not extend to other professionals.
- (d) True.
- (e) False. The seizure of goods and chattels is a collection remedy, not a penalty for an offence under the Act. However, if the penalty is a fine, and payment is not made, the power of seizure may be used to collect the fine.
- (f) False. *Inter vivos* trusts are technically required to make instalment payments, however CRA may not enforce this requirement.
- (g) False. The CRA has the authority to conduct audits requesting the taxpayer's co-operation permitting inspection of books and records without a search warrant.

38. Roles in the tax system:

- (a) Develop a tax policy and draft tax legislation.
- (b) Administration and enforcement of the Act.
- (c) To file annual tax returns, without notice or demand, reporting all sources of income and other information contained in the required tax returns, to estimate tax payable and pay taxes all within the time limits set out in the Act.

39. Reassessments and appeals

- (a) Generally a reassessment is only valid if made within 3 years of the date of mailing of the original Notice of Assessment (note – this is called the “normal reassessment period”). For a reassessment after the normal reassessment period may only be made if CRA can establish certain criteria – i.e. there was a misrepresentation in filing the return, or a fraud has been committed in filing the return, or the taxpayer provided a waiver in respect of the normal reassessment period. Accordingly, not all the Notices of Reassessment may not be valid depending on when the original Notices of Assessment were mailed, and whether or not CRA can establish one of these factors.

- (b) In order to protect the right to appeal the reassessments, the executors must file a Notice of Objection.
 - (c) A Notice of Objection must be filed no later than the later of
 - (i) 90 days from the date of the mailing of the Notice of Assessment or Reassessment, or
 - (ii) one year after the filing deadline for the return of the taxation year under objection.
40. Payments of tax and appeals
- (a) Options re payments of amounts reassessed
 - (i) The executors may pay the amounts of tax owing along with any interest or penalties assessed.
 - (ii) The executors may do nothing regarding payment, since CRA's right to collect will be held in abeyance pending the outcome of the Notice of Objection and any subsequent appeal.
 - (b) Consequences of payment options depending on outcome of appeal
 - (i) If the appeal is successful and the amount was paid, there will be another reassessment, and any overpayment will be refunded by CRA along with interest on the overpayment. The interest must be included in any income of the estate.
 - (ii) To the extent the appeal is unsuccessful, payment of taxes, interest and penalties will again become due along with any additional interest on the amounts owing in respect of an extended time period during which the appeal process proceeded.
41. The executors would have been personally liable for the payment of all reassessed taxes, penalties and interest. The right of an executor, if any, against the beneficiaries to recoup the amounts paid, is not provided for under the Act and would be a legal matter between the executor and the beneficiaries.
42. Providing CRA has not made any inquiries into the matter, or has otherwise become aware of the situation and taken action to reassess Fred, Fran should consider the voluntary disclosure procedure to clear up outstanding taxes, i.e. to report the amount of income for prior years that was not disclosed by Fred including the handyman income and the investment income on the off-shore account. If the disclosure is truly voluntary (i.e. CRA has not threatened with respect to reassessments in respect of this matter) then CRA has a policy not to prosecute offences under the Act or levy certain civil penalties. In addition CRA has discretion to reduce the amount of interest and penalties. However no relief is available for unpaid taxes.
43. As an advisor, you must consider firstly as an ethical matter, and secondly from a criminal law perspective whether you can:

- (a) continue to work with Fran as a client
- (b) provide advice to Fran as an executor
- (c) assist her in the preparation of any tax return or tax form or
- (d) participate in any communication with CRA or any other government agency in respect of tax matter relating to Fred or his estate.

You may wish to consult your professional organisation to determine your specific responsibilities, and may even consult a lawyer to determine if any of the above activities might be considered an offence under the Act and which may expose you to prosecution.

An advisor cannot participate in assisting Fran to request a Clearance Certificate when you know that Fred's tax returns were filed without reporting all income, and that the estate is potentially liable for such taxes. To do so may constitute conspiracy to evade tax, or acquiescing to or assenting to making a false statement, all of which are offences under the Act. NOTE: only some of the language describing the offences under the Act is contained in the materials. This situation should alert you to the dangers of the offences in the Act and the need for legal advice if you are considering continuing to act for, or advise Fran. In fact, the offences also include "...assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer...", as well as "conspiracy with any person to commit an offence".

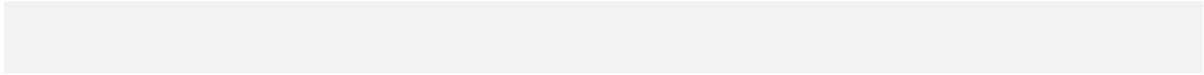
If Fran still wishes to apply for the Clearance Certificate after fully explaining to her the risks she would be taking by requesting the Clearance Certificate under false pretences, including the criminal penalties for evasion, and the fact that there is no time limit for reassessment where there has been misrepresentation, you should refrain from advising her any further. You should be ready to explain to Fran that she is not responsible personally for Fred's conduct, but that if she as executor also participates in evasion, then she is liable to prosecution, fines and imprisonment.

44. Evasion?

- (a) Maybe. This may be evasion if the parent holds the account simply as a "bare trustee" and that the true nature of the arrangement is that the funds and the income belong to the child. If it is a loan, the attribution rule relating to interest-free loans to non-arm's length persons makes the investment income reportable by the transferor. If it is a true gift – i.e. a voluntary transfer to the parent with no conditions, it may be legitimate tax planning.
- (b) No. There was no intention to avoid payment of tax and the omission arose out of an honest mistake
- (c) Yes. This is clearly evasion as it is deliberate and the deceit (hiding) and the omission (to report) are both designed to evade tax liability.

(d) No. Aggressive tax is not evasion where there are is a legitimate argument that the plan will stand up to a formal challenge, even if such challenge ultimately fails. The opinion must be reasonably relied upon by the taxpayer, and the taxpayer must not prepare his returns in a manner that intentionally misleads CRA with respect to the transactions.

(e) No. This is legitimate planning.



Chapter Twelve Review Questions and Answers

QUESTIONS

Assume unless otherwise noted that all parties are Canadian residents who are not considered U.S. citizens or otherwise subject to U.S. tax as U.S. persons.

45. True or False:
- (a) A good planning strategy for U.S. estate tax is to have U.S. investments held in a wholly owned U.S. personal holding corporation.
 - (b) A U.S. citizen is generally subject to U.S. estate tax on their worldwide estate. However, this will not apply if the U.S. citizen moves to Canada and takes out Canadian citizenship.
 - (c) U.S. estate tax may be payable if the worldwide estate of a Canadian exceeds the value of \$3.5 million and the individual died in 2009.
 - (d) US vacation property held in a single use holding corporation may be subject to an assessment for a shareholder benefit under Canadian income tax rules.
 - (e) As long as the value of worldwide property does not exceed the annual exclusion amount of the year of death, no U.S. estate tax is payable and the executors need not file a U.S. estate tax return.
 - (f) With respect to registered plans, a good strategy for U.S. estate tax planning is to transfer all U.S. investment accounts from a U.S. financial institution to a Canadian financial institution.
 - (g) The amount of the unified credit to reduce U.S. estate tax payable depends on the year of death, the value of U.S. property owned at death, and the proportion of the value of the estate that constitutes U.S. property.
 - (h) The marital credit will reduce U.S. estate tax payable if the deceased had a surviving spouse.
 - (i) U.S. gift tax is applicable to all transfers of U.S. property.
 - (j) Although U.S. estate tax is currently not applicable in respect of deaths taking place in 2010 (subject to updates on the website), U.S. gift tax remains applicable to transfers of U.S. property in excess of the annual exclusion amount for gifts.
 - (k) The unified credit can be used to shelter U.S. gift tax on gifts made by U.S. citizens.
 - (l) Income taxes may be avoided in respect of investment income on a foreign inheritance, by investing such inheritance in an off-shore trust.

(m) Canadian residents are required to report ownership of foreign investments where the value at the end of the taxation year exceeds \$100,000 in Canadian dollars.

46. Identify whether each of the following is included in worldwide property for the purposes of U.S. estate tax by indicating “yes” or “no:”

- (i) The death benefit from life insurance held by the deceased, where the deceased was the insured, regardless of who is named as beneficiary.
- (ii) The full value of a registered plan owned by the deceased as at the date of death.
- (iii) The value of a U.S. condominium transferred by the deceased to his children prior to the year of death.
- (iv) 50% of the value of any jointly held property between the deceased and his or her spouse.

47. Molly died with an estate worth \$4,000,000. What information do you need in order to determine the potential liability for U.S. estate tax and her obligations to file a U.S. estate tax return? Explain how the information will be used to determine liability if any?

ANSWERS

True or False

- (a) False. Shares of the U.S. corporation would be U.S. assets for the purposes of U.S. estate tax.
- (b) False.
- (c) True.
- (d) True. Although arrangements in place prior to January 1, 2005 are grandfathered.
- (e) False. A U.S. estate tax return is required if the value of U.S. property exceeds \$60,000US even if no tax is payable.
- (f) False. The location of the investment account is irrelevant. It is the nature of the asset that determines whether or not it is considered U.S. property. The location is relevant only for interests in real property.
- (g) True.
- (h) False. The marital credit is only available with respect to U.S. property that is transferred to the spouse as a consequence of death.
- (i) False. Gifts of U.S. property are subject to an annual exclusion amount for gifts.
- (j) True.

- (k) True. However this is not the case for gifts made by non-resident aliens of the U.S. – i.e. Canadian residents who are not U.S. citizens.
- (l) False. Off-shore trusts may be used to shelter tax from investment income on a foreign inheritance, but the trust must be set up by an off-shore benefactor. If the Canadian resident inherits directly, the opportunity is lost. Where done prior to death, the off-shore trust will be the beneficiary of the inheritance, and the Canadian heir will be the beneficiary of the off-shore trust.
- (m) False. Only when the value of such property exceeds \$100,000 based on *the cost of such property* need it be reported. NOTE: Personal-use property, such as a Florida vacation home is excluded, as are any investments in a RRSP or RRIF.

48. Worldwide Property

- (i) Yes.
- (ii) Yes.
- (iii) No. Note however that such a transfer would be subject to U.S. gift tax.
- (iv) No. It is worldwide property, but the full value is considered worldwide property unless the property is held jointly *without a right of survivorship*. The value of property held jointly with a right of survivorship may only be reduced by any contribution made by a surviving joint owner that the personal representative can prove to the IRS by providing evidence of such contribution

49. Needed information and how it will affect liability and/or requirement to file U.S. return:

- (a) Value of Molly's worldwide estate for U.S. estate tax purposes: if the value is below the annual exclusion amount, there will be no U.S. estate tax liability. The value will also be used in the calculation of the amount of Unified Credit available.
- (b) Identify whether she owned U.S. property at death and the value of U.S. property at the date of death. If the value exceeds \$60,000US, the executor is required to file a U.S. estate tax return. The value will also be needed to determine the amount of U.S. estate tax, and used in the calculation of the amount of Unified Credit available.
- (c) Marital status - Is Molly married, and if so will her spouse inherit any U.S. property? This will determine whether any marital credit is available. NOTE: The value of U.S. property inherited by the spouse will affect the amount of the marital credit available.

NOTE: Also relevant - Is there any Canadian tax credit available to reduce taxes payable on her Canadian return in respect of U.S. estate tax payable? This will not reduce U.S. estate tax, but effectively reduces the cost of U.S. estate tax by reducing Canadian tax payable on death.