

Sample Exam Questions for Taxation of Trusts and Estates

The following questions are offered to provide a sense of the **type** of questions you might expect on the exam. They do **not** reflect an entire exam.

Every exam will differ. In this case, you are required to select from a list of responses to indicate if statements are true or false, to match statements to questions, and to answer multiple-choice questions. The remaining questions will require you to analyze scenarios in order to identify and apply relevant legal principles.

You are reminded to always read the question carefully. For example, questions that may seem similar to questions from Review Questions or Supplementary Materials may be slightly different. These changes will affect the answer and/or the scope of the answer required.

Full text answers are not provided to the questions requiring analysis. Rather, for the purpose of this sample, key points that should be raised are noted in bullet form. Full text answers would be required on the exam.

You should also refer to:

- [STEP Diploma for Canada Exam Rules & Regulations](#), and
- [Tips for Preparing for and Writing a STEP Diploma for Canada Exam](#).

QUESTIONS:

Type A: True/False Questions

Indicate whether the statement is true or false by circling the letter “T” or “F”
[5 marks]

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|----|--|----------|----------|
| A1 | The transfer of a Florida vacation property from the sole name of the husband into the name of the ¹ wife in 2010 with no consideration, will be subject to U.S. gift tax if the value of the property exceeds \$134,000US. | T | F |
| A2 | Income paid or payable by a trust to a beneficiary who suffers from a disability will not be taxable to that beneficiary if the preferred beneficiary election is made. | T | F |

A3	Capital losses may only be applied to reduce capital gains.	T	F
A4	Where there is an unrealised gain on capital property transferred to a qualifying spousal trust and the transferor elects out of the rollover on the transfer, the cost of the property to the trust will be equal to the fair market value of the property at the time of the transfer.	T	F
A5	A taxpayer must file a Notice of Objection within 90 days of the mailing of the notice of assessment or reassessment, as the case may be.	T	F

Type B: Yes-No Questions

B1. Identify whether or not each of the following items may result in the application of the attribution rules by indicating “yes” or “no” for each and **also provide a brief explanation**.
[12 marks]

- B1 (a) A sale of property from a taxpayer to a discretionary family trust for proceeds equal to fair market value paid by way of a non-interest bearing promissory note where the beneficiaries of the trust are the taxpayer’s adult children and their issue.
- B1 (b) A testamentary “non-qualifying” spousal trust (i.e. one that fails to qualify for the rollover on death because the spouse is not entitled to all the net income during lifetime).
- B1 (c) Capital gains realized in a discretionary family trust for the benefit of the settlor’s minor children where the settlor and his spouse are the trustees.
- B1 (d) Dividend income from shares of public corporations accumulated in an age 40 trust where the trust was funded by a cash gift from the grandmother of beneficiaries who are all under age 18.
- B1 (e) A trust set up to hold the common shares issued in the course of an estate freeze where the shares were purchased from treasury with the funds from an arm’s length loan
- B1 (f) A gift by an individual to a trust for the benefit of his or her parents with a residual “gift over” on the death of the parents to the individual and his or her spouse

B2. Identify whether or not each of the following statements is correct with respect to distribution of property by a trust in satisfaction of a capital interest in the trust by circling “Yes” or “No” for each. [4 marks]

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|--------|--|------------|-----------|
| B2 (a) | If subsection 75(2) applies, a rollover will never be possible for a distribution of capital property to a beneficiary. | Yes | No |
| B2 (b) | There will be a deemed disposition at fair market value on the distribution of property to the settlor of an alter ego trust. | Yes | No |
| B2 (c) | There may be tax consequences to a trust where there is a distribution in kind of property to a non-resident of Canada. | Yes | No |
| B2 (d) | A trust may elect out of the rollover on distribution of a residence and use the principal residence exemption to shelter any resulting capital gain if one or more of the beneficiaries has used the property as a principal residence during the trust holding period. | Yes | No |

B3. Identify whether or not each of the following statements is correct with respect the treatment of RRSP plan proceeds on death of the annuitant by circling “Yes” or No” for each. [5 marks]

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|--------|--|------------|-----------|
| B3 (a) | Except in the case of a matured RRSP where the spouse is the beneficiary, or where the plan proceeds qualify as a refund of premiums, the value of the proceeds of an RRSP as at the date of death are included in the terminal return and the liability must be paid by the personal representatives of the deceased from the assets of the estate. | Yes | No |
| B3 (b) | Where the surviving spouse is the named beneficiary of an unmatured RRSP, the spouse will be taxable on the plan proceeds as a refund of premiums unless the spouse contributes the proceeds to his or her own plan. | Yes | No |
| B3 (c) | Where the beneficiary of the RRSP is an adult child of the deceased annuitant, who was financially dependent on the deceased by reason of physical infirmity, the proceeds can be rolled over to a lifetime benefit trust for the benefit of the child. | Yes | No |
| B3 (d) | Where the estate of the deceased annuitant is bankrupt CRA may collect the tax owing on the RRSP proceeds from the beneficiary of the plan. | Yes | No |

B3 (e) There is no withholding tax on the payment of the proceeds of an RRSP plan on death	Yes	No
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Type C: Scenarios for Analysis

C1: Jack and Jill estate planning [15 marks]

Jack and Jill, aged 36, were high school sweethearts. They have been married for 8 years and have two children, aged 6 and 4. They own a home in Peterborough, Ontario worth \$225,000 with an insured \$170,000 mortgage. Jack works for the Bank of Nova Scotia and has a defined benefit pension plan. Jill works part-time as a school teacher for the local Board of Education and belongs to the Ontario Teachers' Pension Plan. Jack and Jill have come to you for estate planning advice. They have an "I love you" Will that was prepared by the lawyer who handled the purchase of their home six years ago. Note: A simple Will where everything passes to the spouse with a simple gift over to children and no trusts other than for minors is sometimes referred to as an "I love you" Will.

- a) What questions might you ask Jack and Jill to uncover additional assets that might be relevant in tax planning for their estates? Explain why you think these additional sources of wealth may be relevant. [4 marks]

- b) Assuming significant wealth may pass on either Jack or Jill's death, what additional tax planning strategies might you suggest for their estate plan using testamentary trusts? Provide brief details of the strategies and explain how they may achieve tax savings.

C.2 [20 marks]

The XYZ Trust is an *inter vivos* discretionary family trust with three beneficiaries, age 16, 18 and 21. While discretionary payments of income are provided for in the trust, there is no power to encroach on capital. The following information is available for the trust in the current year:

- Actual eligible dividends - \$14,583
- Taxable eligible dividends - \$21,000
- Foreign source income - \$1,200
- Capital gains - \$15,000
- Capital losses - \$3,000
- Interest income - \$18,000
- Interest and other deductible expenses from income from property - \$2,000

- (a) What is the net income of the trust before allocations of income to beneficiaries? Show your calculations. [3 marks]

- (b) Payments of \$10,000 have been made during the year to or on behalf of each beneficiary. Explain to the trustees the ways in which these payments may be characterised in trust law, and in tax law. Give your recommendation as to how the payments might be characterised. Provide reasons. Calculations are not required. [8 marks]
- (c) Assume now that the trust has a net capital loss from a previous taxation year of \$2,000. Discuss how the trust may be able use this loss. How would your answer differ if under the terms of the trust all income and capital gains were payable to the beneficiaries in the year? [4 marks]
- (d) In preparing the returns of the trust for the year, the accountant has applied the expenses against the interest for the purposes of allocating and designating income distributions to the beneficiaries. Why were the expenses not applied against dividends or foreign income, which are also income from property? [2 marks]
- (e) What steps need to be taken to make sure the beneficiaries are taxable on all income from the trust, and will include such amounts in their tax returns? [3 marks]

ANSWERS

Note: For Type A and questions and Type B questions (except for B1 where an explanation is requested) the explanations are given here only for study purposes. No marks will be given for an explanation on the exam for these types of questions ***unless you are specifically asked to provide an explanation.***

Type A: True/False

A1 -True – U.S. gift tax applies in 2010. Note: even if there is no U.S. estate tax (check website for updates on changes to U.S. estate tax).

A2 -False – the reverse is true – the election permits income not paid or payable to be taxable in the disabled beneficiary's hands.

A3 –False – there is an exception for the year of death and possibly the prior year.

A4 –True –the election results in the property being transferred at fair market value for tax purposes to both the transferor (proceeds of disposition) and the transferee trust (acquisition cost).

A5 –False- the deadline is the later of 90 day after the Notice of Assessment or one year after the filing deadline for the taxation year in question

Type B: Yes/No Questions

- B1 Application of attribution rules with brief explanation
- B1 a) Yes The inclusion of “issue” as beneficiaries could include related persons under age 18 and the exception for fair market value transfers does not apply because the note is non interest bearing.
- B1 b) No. There is no attribution associated with testamentary trusts.
- B1 c) Yes. The settlor attribution rule in subsection 75(2) would apply.
- B1 d) Yes. There would be attribution to the grandmother because the beneficiaries are under age 18. The rules relating to “fixed interest” age 40 trusts only are relevant if the other attribution rules do not apply.
- B1 e) No. This is a common method of subscribing for “growth” type shares in an estate freeze to avoid attribution on the growth shares.
- B1 f) Yes. This is a reversionary trust and subsection 75(2) will apply.
- B2 Distribution of property by a trust in satisfaction of a capital interest in a trust
- B2 a) False – only during the lifetime of the settlor.
- B2 b) False – distributions to the settlor of an alter ego trust take place on a rollover basis.
- B2 c) True
- B2 d) True.
- B3 RRSP’s
- B3 a) True
- B3 b) False
- B3 c) False
- B3 d) True
- B3 e) True

Type C: Scenarios for Analysis

C1: Jack and Jill

- a) Additional sources of wealth might include life insurance and inheritances from their parents. Each of Jack and Jill has employers who may provide for group life insurance benefits or, they may have additional insurance over and above that of their insured mortgage. Given their age, it is possible in the future that Jack or Jill may inherit wealth from their parents or other family members. [4 marks]

free distribution of capital. The amounts paid may be allocated as income from a trust, and a designation may be made to characterise them in the hands of the beneficiaries as one or more of the other sources of income (other than capital gains) listed above. The income before net taxable capital gains is \$38,200. Thus \$8,200 of the net income need not be allocated or designated.

A good recommendation is to designate dividends to the maximum amount first, because of the dividend tax credit. The next item to designate would be foreign source income because of a possible right to a foreign tax credit. The balance can be interest income, although no designation as to character is available and it will simply be income from a trust in the hands of the beneficiary. In allocating and designating the amounts of net income as between the beneficiaries, this is flexible – it can be done in proportions for each type of income to each beneficiary, or the types of income can be allocated in different amounts to each beneficiary as long as the total amount is \$10,000 for each beneficiary. (Note that in calculating the amount dividends to be designated and allocated to the beneficiaries, it is only the actual amount of the dividends not the taxable amount that need to have been paid to the beneficiaries.)

- c) The trust has an option to apply all or any part of the net capital loss to reduce the net taxable capital gains of the trust in the current taxation year. If all capital gains were payable to the beneficiaries in the year, the trust make a designation (under subsection 104(13.2) – but section number is not needed for answer) to have any amount of the taxable capital gain taxed in the trust in which case it would not be taxable to the beneficiaries, and the trust could carryforward the net capital loss from prior years to offset the amount designated to be taxed in the trust. Since only \$2,000 of net capital losses from prior years is available, the trust should designate \$2,000 of taxable capital gains to be included in trust income.
- d) Interest income has no preferred treatment. However, the eligible dividends are entitled to an enhanced dividend tax credit, and a foreign tax credit may be available in respect of foreign income.
- e) In order for the income to be taxable to the beneficiaries, it must be paid or payable to them in the year. Since payments were made, and under the terms of the trust these only could have been paid from income of the trust, the amounts will be taxable in the hands of the beneficiaries, assuming no designation is made otherwise. The trustees must prepare the T-3 tax return for the trust along with the T3 Summary and the T3 Slips. One copy of the T3 slips must be sent to the beneficiaries and the income must be reported in each of their T1 tax returns for the year.