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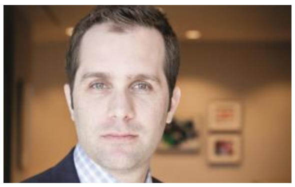
2014 Federal Budget Trust Update[1]



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The 2014 Federal budget proposes a number of changes to the taxation of "testamentary trusts" (trusts created upon the death of an individual pursuant to a Will) as well as an elimination of the tax benefits associated with the use of "immigration trusts". These proposed changes, among others, continue the government's ongoing attempt to address perceived tax loopholes.

Taxation of Testamentary Trusts

First introduced in the 2013 Federal budget, the 2014 Federal budget proposes a number of changes to the taxation of testamentary trusts that will, among other things, eliminate the access of testamentary trusts to graduated rates of tax. Instead, each testamentary trust will be subject to a flat rate of tax on all of its income at the highest marginal tax rate. An exception to this rule will be to provide an estate (itself a testamentary trust) continued access to graduated rates for the first 36 months of its existence.

My colleague, Rachel Goldman, and I had previously written about the use of testamentary trusts in a Will for tax purposes,[2] suggesting that an individual who was otherwise going to bequest a portion of his estate outright to an individual should instead consider the use of a "tax-planned testamentary trust" wherein an individual's inheritance would, rather than being paid outright to him, be placed into a testamentary trust of which the individual would be the sole trustee, for such individual's sole benefit. This would allow the individual to control his inheritance while providing him with access to an extra set of graduated rates of tax. We went even further, suggesting the use of *multiple* tax-planned testamentary trusts in a Will for a number of individuals in order to multiply the accessibility to the graduated rates of tax. The proposed changes in the 2014 Budget, will significantly curtail the use of these "tax-planned testamentary trusts" and will completely eliminate the ability to multiply the annual tax savings.

[1] Originally published in the *Minden Brief* 2014 Spring Edition.
[2] *Tax Planning Your Will - Part 1, Part 2*; July and November 2012. Available at www.mindengross.com.

While hindered, the tax-planning opportunities associated with testamentary trusts are not *completely* lost. The 36-month access of an estate to graduated rates of tax presents an opportunity to enjoy the use of an extra set of graduated rates for the fi rst three years following an individual's death. Where an individual would otherwise bequest his estate outright to one or more individuals, consideration should be given to retaining the estate in trust for at least the first 36 months following the individual's death. The extra set of graduated rates for those 36 months, based on current tax rates, can result in aggregate tax savings to the estate (and thus the beneficiary or beneficiaries) in excess of $100,000.

Another planning note to consider is that the changes to the taxation of testamentary trusts will only apply to the 2016 and subsequent taxation years. As a result, consideration should be given to taking advantage of an existing testamentary trust's access to graduated rates before the end of 2015 – whether by paying dividends to the trust, disposing and re-acquiring assets that would have otherwise been disposed of shortly thereafter, or otherwise.

Immigration Trusts

One of a number of ways in which a trust is deemed to be resident in Canada – and thus subject to tax on its worldwide income – is where a resident of Canada has made a contribution to it. An exception, however, is made where the contributor was a resident of Canada for a period of not more than 60 months. Non-residents relocating to Canada often took advantage of this exception, and thus the term "immigration trust" was born. When properly implemented, both the income earned in an immigration trust over the course of this time period would not be not be taxed in Canada and the cost of the trust's assets could be "bumped up" to their fair market value at the expiration of such period. If the immigration trust was resident in a low or no tax jurisdiction (as was commonly the case) during this time, any income earned from the trust's assets, and any growth thereon, could be enjoyed with the incurrence of little or no tax.

The 2014 Federal budget proposes to eliminate the tax benefits associated with immigration trusts by eliminating the 60-month exception. The proposed changes will not only deter the future use of immigration trusts but will affect those immigration trusts already in existence. The limited transitional relief provides that existing immigration trusts can continue to enjoy the "tax holiday" until the end of 2014 so long as no contributions are made to the immigration trust after February 10, 2014 and before 2015. On top of being mindful in this regard, consideration should be given to taking steps before 2015 – whether it be winding up the trust, migrating the trust to Canada or otherwise - in order to "step up" the costs of the assets of existing immigration trusts.

For more information on Income Splitting, Succession Planning or Personal or Corporate Tax Planning, please contact Matthew Getzler at mgetzler@mindengross.com.