Tax Issues for Estate Administration Lawyers

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This paper will discuss a limited selection of Canadian income tax issues arising in estate administration[1] as follows.

- Testamentary trust status
- Distribution to a non-resident beneficiary – section 116 compliance
- Reassessment issues – timing and who can be assessed

It is assumed that the estate is a resident of Canada for income tax purposes, *i.e.*, applying the common law test of residence,[2] central management and control of the estate is in Canada.

I. Testamentary Trust Status

A critical requirement for graduated rate estate[3] status is that the estate must be a testamentary trust as defined in subsection 108(1). A trust that is provided for in the Will of the deceased is not automatically a testamentary trust and a trust that is initially a testamentary trust may later cease to meet the statutory definition and therefore cease to be a testamentary trust. Loss of testamentary trust status at any time in the 36 months following the death of the deceased taxpayer results in loss of graduated rate estate status and a deemed year end.[4] Graduated rate estate status is important for certain income tax advantages including, but not limited to, the following:

- Entitled to the benefit of the marginal rates of taxation for up to 36 months
- May have a non-calendar year end
- Not required to make tax instalment payments
- Greater flexibility with respect to charitable giving

The definition of "testamentary trust" in subsection 108(1) states that a testamentary trust is a trust that arose on and as a consequence of the death of an individual (the "Deceased"). The two exclusions in paragraphs (a) and (c) of the definition[5] will cause a trust to not be a testamentary trust and while paragraph (d) thereof is considered an anti-avoidance rule, it is easy to fall into. These provisions are discussed below.

Testamentary Trust definition, paragraph (a) exclusion

Pursuant to paragraph (a) of the definition, a trust created by a person other than the Deceased will not qualify.

Testamentary Trust definition, paragraph (c) exclusion

Pursuant to paragraph (c) of the definition, if property is contributed to the trust otherwise than by the Deceased on or after the Deceased's death and as a consequence thereof, the trust will not qualify. The leading case on the meaning of "property … contributed to the trust" is *Greenberg Estate v. The Queen,*[6] which held that a contribution was a voluntary payment, made for no consideration and for the purpose of increasing the capital of the estate.

For example, if the estate is a beneficiary of an *inter vivos* trust, CRA's view is that this is problematic.[7] Further, while not entirely clear, it appears that if property pours into an estate upon the termination of an alter ego trust as a consequence of the death of the so-called primary or life beneficiary, the exclusion in paragraph (c) may be triggered for the following reasons:

- While at first instance, it might appear that the Deceased contributes the property to the estate, strictly speaking, property is contributed to the estate by the alter ego trust.
- Further, although the Deceased contributed property to the alter ego trust when such trust was settled, it is possible that the initially-contributed property may no longer exist at the time the alter ego trust terminates. If so, absent a substituted property or tracing concept (which is not provided for in the particular section), the property contributed by the alter ego trust is not the same property that the Deceased contributed upon settlement of the trust.
- Finally, while the death of the Deceased is a triggering event causing those clauses of the alter ego trust dealing with distribution upon the death of the Deceased as primary beneficiary to become operative, it seems that the property is contributed as a consequence of the terms of the alter ego trust rather than as a consequence of the Deceased's death. Arguably, paragraph 248(8)(a)[8] may address this last concern, if the alter ego trust to be "a will or other testamentary instrument". This saving provision states that a transfer of property as a consequence of terms of "a will or other testamentary instrument" to be a transfer as a consequence of the death. However, while an alter ego trust is often colloquially referred to as a will substitute, it is not clear that it is a "testamentary instrument".

If the Deceased was the owner of an insurance policy where his/her estate is designated as beneficiary and the insurance proceeds are paid into the estate, this does not cause a problem with qualification. CRA does not regard the payment of the insurance proceeds as a contribution otherwise than by the Deceased, because the Deceased was the policy owner.[9] This should also be the case where the estate is designated as beneficiary of the Deceased's registered plans (*i.e.,* RRSP, RRIF, TFSA).

Testamentary Trust definition, paragraph (d) anti-avoidance re indebtedness

The anti-avoidance rule in paragraph (d) of the definition was enacted at a time when all testamentary trusts enjoyed the benefit of marginal rates and was intended to prevent income splitting whereby individuals would lend funds to the trust so the estate could generate investment income taxed at marginal rates. While the marginal rate advantage is no longer automatically available, paragraph (d) remains part of the definition and can be inadvertently triggered. Paragraph (d) is triggered where the trust incurs a debt to a “specified party” or has a debt that is guaranteed by a “specified party”. A “specified party” is a beneficiary or a person who is non-arm’s length with a beneficiary of the trust. Therefore, if the estate has an amount owing to a beneficiary or any person who is non-arm’s length to a beneficiary, this is problematic unless the situation fits into one of the following exclusions:

(i) a debt of the trust to a “specified party” who is a beneficiary because the “specified party” in its capacity as beneficiary can enforce payment of income or capital gains of the trust.

This exclusion likely derives from the “payable” prerequisite for income of the trust to be taxed in the hands of a beneficiary pursuant to subsection 104(13) and deducted from the income of the trust pursuant to subsection 104(6). An amount is deemed not to be payable for this purpose unless it is paid or the beneficiary is entitled to enforce payment.[10] In this case, although the trust has an amount owing to the beneficiary, this debt obligation does not trigger paragraph (d).

(ii) a debt of the trust owed to a “specified party” which arose because of a service[11] rendered by the “specified party” to or for the benefit of the trust.

For example, if a “specified party” is a professional who has billed the trust for his/her professional services, it appears that the resultant debt obligation of the trust should not trigger paragraph (d). If a “specified party” charges the trust a fee for guaranteeing a loan, it seems that the debt obligation arising from the guarantee fee may not trigger paragraph (d), because it arises from a service provided, but the loan itself should be reviewed.

(iii) a debt owed to the “specified party” if:

(A) the debt arises because the “specified party” made a payment on behalf of the trust

(B) the trust reimburses the “specified party” in full within 12 months of the payment[12]

(C) it is reasonable to conclude that the “specified party” would have been willing to make the payment if the “specified party” and the trust were arm’s length (the “Arm’s Length Reasonableness Requirement”).

It is important to note that the Arm’s Length Reasonableness Requirement does not apply where the trust is the estate of the Deceased and the payment is made within the first 12 months following death.[13] See further discussion below.

It is not clear how the Arm’s Length Reasonableness Requirement should be applied. Under the ITA, a beneficiary of a trust is deemed to be non-arm’s length with the trust.[14] Does the Arm’s Length Reasonableness Requirement mean that one ignores the fact that causes the non-arm’s length relationship, *i.e.,* that the particular “specified party” is a beneficiary of the estate? If so, then it seems that the expectation of receipt of funds or property under the terms of the Will cannot in and of itself be the reason that the “specified party” would be willing to make the payment. The preamble to the Arm’s Length Reasonableness Requirement uses the words “it is reasonable to conclude.” This suggests an objective test. Arguably, an arm’s length person would be willing to pay an amount on behalf of another person if there are arrangements for reimbursement in place, perhaps in writing, and the arm’s length person is satisfied with the covenant to reimburse. The latter imports a creditworthiness check and possibly compensation such as interest.

Where an estate is illiquid, caution must be exercised with respect to paragraph (d). For example, a “specified party” could pay funeral expenses or other expenses on behalf of the estate and as long as he/she is fully reimbursed within 12 months of death, paragraph (d) is not triggered. Providing assistance for funding of tax liability may be problematic as the taxes may not be payable within the first 12 months following death and therefore would not be reimbursed within 12 months of death. For example, where an individual passes away in January, the terminal income tax return is not due until April 30 of the following calendar year, which is more than 12 months following death. In this case, if a “specified party” pays the tax liability on behalf of the estate at the time of filing of the terminal income tax return, he/she will necessarily not be reimbursed until greater than 12 months following death. It is important to note that written application may be made to CRA to extend the above period, but the written application must be submitted within the statutorily stipulated 12 month period, *i.e.,* within the 12 months following death. Also, the extension is subject to CRA’s determination of reasonableness. Absent such extension, the Arm’s Length Reasonableness Requirement must be satisfied where the reimbursement is made outside the first 12 months following death. The choice of 12 months following death may seem arbitrary,[15] but it aligns with the so-called executor’s year.

II. Distribution to a Non-Resident Beneficiary – Section 116, Compliance

A trustee or estate trustee may face a section 116 compliance issue at the time of distribution to a non-resident beneficiary[16] even if the estate does not own Canadian situate real estate at the time. Readers may be familiar with the regime under section 116 in the context of a sale of Canadian real property by a non-resident. In these circumstances, where a non-resident does not provide the purchaser with a certificate of compliance under section 116 (sometimes colloquially referred to as a "section 116 clearance certificate") with a certificate limit equal to the sale price, the purchaser is liable and is required to remit to the Receiver General an amount equal to 25% of the purchaser's cost[17] 30 days after the end of the month in which the purchaser acquired the property.

Is the interest in the estate "taxable Canadian property"?

Technically the section 116 regime applies to a disposition of "taxable Canadian property" as defined in the ITA. It is well known that real property situated in Canada is taxable Canadian property. But how might the section 116 regime apply to a distribution by an estate trustee? Prior to amendments to the ITA in 2010,[18] a capital interest in a trust resident in Canada was taxable Canadian property. Thus, prior to such statutory amendments, every distribution of capital from a trust or estate to a non-resident beneficiary required section 116 compliance.[19] Under the current definition of "taxable Canadian property", an interest in a trust is taxable Canadian property if at any time in the immediately preceding 60 months, more than 50% of the fair market value of the interest was derived directly or indirectly from real property situate in Canada including through a corporation, partnership, or trust the shares or interests in which were themselves taxable Canadian property. The measurement period is therefore the 60 month period preceding the time of distribution of capital to a non-resident beneficiary.

If an estate owns Canadian real estate, and at the time of distribution of capital to the non-resident beneficiary, more than 50% of the fair market value of the estate derives from Canadian real estate, then an interest in the estate will constitute taxable Canadian property. However, it is also possible that while the estate no longer owns Canadian real estate at the time of distribution, at some point in the immediately preceding 60 months, more than 50% of the fair market value of the estate derived from Canadian real estate. For example, the deceased's home may be a substantial asset of the estate that the estate trustee liquidates in the course of administration. At the time of distribution to the non-resident beneficiary, the assets of the estate may comprise cash only. However, if the value of such a home (together with other Canadian real estate assets, if any) represented more than 50% of the fair market value of all assets of the estate at any time in the 60 months preceding the distribution, then at the time of distribution to the non-resident beneficiary, an interest in the estate will be taxable Canadian property.[20]

Anomalous words – disposition and purchaser

A prerequisite to the application of section 116 is a disposition of taxable Canadian property. It is not obvious that a distribution from an estate to a beneficiary means that the beneficiary disposed of an interest in the estate. Also, the concept of disposition may seem puzzling where there is an interim distribution because the estate continues following the distribution, and the beneficiary continues to have an interest in the estate. However, the term "disposition" is defined in the ITA; a distribution made to a capital beneficiary should fall within paragraph (d) of the definition in subsection 248(1) and is therefore a disposition. The specific words are reproduced below:

> disposition – "disposition" of any property, except as otherwise expressly provided, includes
>
> (d) where the property is, or is part of, a taxpayer's capital interest in a trust, except as provided by paragraphs (h) or (i), a payment made after 1999 to the taxpayer from the trust that can reasonably be considered to have been made because of the taxpayer's capital interest in the trust"[21]

Another anomalous word in section 116 in the context of a distribution from an estate is the word "purchaser". Specifically, section 116 refers to the purchaser who acquires taxable Canadian property from the non-resident. The identity of the purchaser and what such a purchaser acquires is obvious in the case of the typical non-resident individual selling Canadian real estate. However, in the case of a non-resident beneficiary receiving a distribution from an estate, who is the purchaser? Is the estate the purchaser for this purpose and if yes, what does it acquire? If the taxable Canadian property is the interest in the trust (estate), and the estate is the purchaser, query how the estate itself acquires same. One commentator has suggested that what the estate (trustee) acquires is a release.[22] CRA's position is that the estate is considered the purchaser for purposes of section 116.

Section 116 procedure

The standard section 116 procedure involves the submission of Form T2062 to CRA no later than 10 days after the disposition.[23] This can be a time consuming and prolonged procedure as it is necessary to wait for a reply and the issuance of a certificate. However, either an exemption or an abbreviated procedure may be available depending on the non-resident beneficiary's country of residence, the terms of Canada's bilateral tax treaty with that country, and the identity of the estate trustee.

The disposition of "treaty-exempt property" is excluded from the application of section 116.[24] "Treaty-exempt property" characterization has two components. Component (a) requires that the gain from the disposition of the property be exempt from Canadian taxation because of a tax treaty, and subject to component (b) can result in an exemption from the section 116 procedure. Component (b) applies only if the non-resident and the purchaser (meaning the estate for this purpose) are related. If the parties are related, then component (b) requires Form T2062C to be filed within 30 days of the disposition. The latter is simply a notice requirement and hence is an abbreviated procedure.

"Treaty-exempt property", component (a)

Assume that the non-resident beneficiary is resident in the US so that he/she is entitled to the benefits of the Canada-US Tax Treaty. Article XIII of the Canada-US Tax Treaty relates to the taxation of gains. Article XIII, paragraph 1 provides that gains realized by a resident of one state from the alienation of real property in the other state may be taxed in the other state. Therefore, as a general rule, Canada may tax the gain realized by a US resident on the transfer of Canadian situate real estate. Article XIII, paragraph 3(b)(iii) provides that an interest in a trust whose value derives principally from real property in Canada (with no provision for a look back period), may be taxed by Canada. Because the ITA definition of taxable Canadian property has a look back period but the Canada-US Tax Treaty does not, circumstances can arise where the Treaty prevents Canada from taxing the disposition, notwithstanding the definition of taxable Canadian property being satisfied. Specifically, as discussed above, an interest in an estate may constitute taxable Canadian property where its value derived more than 50% from real property in Canada in the past 60 months. Accordingly, it is possible that an interest in an estate may be taxable Canadian property to which section 116 compliance may be required, yet not taxable by Canada under the Canada-US Tax Treaty.

"Treaty-exempt property", component (b)

If the interest in the estate is taxable Canadian property and also satisfies component (a) of "treaty-exempt property", section 116 compliance depends on the question of whether the non-resident beneficiary and the estate are related.

If the non-resident beneficiary and the estate are <u>not related</u> – then the interest in the estate is "treaty-exempt property" and no section 116 compliance is needed. This is an exemption.

If the non-resident beneficiary and the estate are <u>related</u> – Form T2062C must be filed with CRA within 30 days of the disposition. This is the filing of a notice only and is therefore an abbreviated procedure.

Is a beneficiary related to the estate? This is not clear as the related person provisions[25] in the ITA do not expressly contemplate a trust. CRA looks to the trustee who has control of the trust property and considers the trust to be related to each person who is related to that trustee.[26] Where there is a single estate trustee, CRA's position can readily be applied but where there are multiple estate trustees, some of whom may be family friends and/or trusted advisors, this is more difficult to apply. For example, if there is a sole estate trustee who is the daughter of the deceased, then CRA's position is that individuals who are related to the daughter are also related to the estate. In this case, assuming the non-resident beneficiary is a child of the deceased who is a sibling of the sole estate trustee, CRA's position would be that the non-resident beneficiary is related to the estate.

But suppose there are three estate trustees being two children of the deceased, and a third individual who was a long-time friend and advisor to the deceased, and further assume that the Will contained a majority decision making clause. In this latter case, it is unclear whether a non-resident sibling of two of the estate trustees may be considered related to the estate. CRA's administrative position has been the subject of some critical commentary.[27]

Filing deadlines

There are no provisions for late filing. It is unclear whether CRA may administratively accept a late filing.

Penalties for Non-Compliance

It may not be clear whether an interest in the estate is taxable Canadian property because of the 60 month look back test and the comparative valuation of Canadian situate real estate to other assets. If there is no section 116 compliance prior to the distribution to the non-resident beneficiary where an interest in the estate is taxable Canadian property but is not "treaty-exempt property", the estate trustee may be at risk of assessment for an amount equal to 25% of the distribution (this is the amount that the estate trustee should have withheld and remitted 30 days after the end of the month in which the distribution was made[28]). Such an assessment may be made "at any time".[29] These words create open ended risk for the estate trustee in these circumstances. In addition, a penalty equal to 10% of the amount which should have been remitted may be assessed.[30]

III. Reassessment Issues

Timing of Reassessment - when

It is well known that under the ITA, there is an obligation to file a terminal income tax return, which reports the deemed disposition of property for proceeds of disposition equal to fair market value immediately before the death of an individual, subject to the so-called spousal rollover where property passes to a surviving spouse or a testamentary spousal trust. The terminal income tax return must be filed by April 30 in the calendar year following the year of death, or where the date of death is after October, within 6 months of the date of death. The terminal income tax return is subject to the usual rules in the ITA regarding the period within which CRA may reassess the return. As a general rule, in the case of an individual, a return may be reassessed during the 3 year period commencing on the date of mailing of the notice of original assessment. This is referred to as the "normal reassessment period".[31] However, pursuant to subparagraph 152(4)(a)(i), a return may be reassessed at any time if the taxpayer or person filing the return made a misrepresentation that is attributable to neglect, carelessness or wilful default (the "Open-ended Reassessment Period"). This could lead to a reassessment well past the 3 year period.

Lewin Estate v. The Queen[32] ("*Lewin Estate*") is a case involving the Open Reassessment Period.

Mr. Lewin died on November 12, 2008.

The original assessment for the terminal return was dated June 1, 2009 so that the normal reassessment period ended June 1, 2012.

CRA issued a notice of reassessment dated May 5, 2014.

The taxpayer in *Lewin Estate* appealed on the basis that the notice of reassessment was statute barred. At the date of death, the deceased owned shares of a holding company ("Holdings") which owned shares of a subsidiary ("Gants"), which in turn owned shares of a lower tier subsidiary ("LLH"). There were three estate trustees and one was an accountant ("Mr. LG CA") whose firm had been doing the accounting work and preparing income tax returns for Mr. Lewin, Holdings, and Gants for over 15 years but a different accounting firm did the work for LLH. Although there were three estate trustees, the facts stated that Mr. LG CA "was in charge of filing the terminal return."[33] For purposes of the terminal return, there had to be a determination of the fair market value of the shares of Holdings held by Mr. Lewin immediately before his death. In making the determination of value to report the deemed proceeds of disposition in the terminal income tax return, Mr. LG CA did not take into account the subsidiary, Gants, or the lower tier subsidiary, LLH. The issue in the case was whether the error in valuation (as reflected in the reported deemed proceeds of disposition) constituted a misrepresentation in the return and if so, whether the misrepresentation was attributable to neglect, carelessness, or willful default.

Jurisprudence holds that an error in a tax return is a misrepresentation for purposes of subparagraph 152(4)(a)(ii) and the Court in *Lewin Estate* cited same.[34] Further, negligence for this purpose has been held to mean lack of reasonable care.[35] The Court held that there was an error and further held that the evidence supported a finding that the determination of the fair market value of the shares of Holdings had not been carried out with reasonable care. At trial, Mr. LG CA did not have a cogent explanation for not taking into account the value of the two subsidiaries. He was quite aware of the existence of the subsidiaries. As a result, the appeal was dismissed.

Vine Estate v. The Queen[36] ("*Vine Estate*") is another case where the Court upheld CRA's issuance of a notice of reassessment after the end of the normal reassessment period on the basis that there had been a misrepresentation in the terminal income tax return attributable to neglect, carelessness or willful default. The late Mr. Vine owned shares of private companies and an undivided 50% interest in certain real estate known as "Victoria Park". The estate trustees were Mr. Vine's daughter and son-in-law and they relied upon Mr. Vine's accountants to prepare the terminal income tax return. It appeared that neither reviewed the return in any comprehensive fashion or asked any substantive questions. There was an error in the terminal tax return. The accountants reported the deemed disposition of Mr. Vine's interest in "Victoria Park" as if it was a partnership interest instead of a direct ownership interest in real property. A disposition of a partnership interest results in a capital gain only. A disposition of a direct ownership interest in real property results in both capital gain and recapture. In *Vine Estate*, if the latter (*i.e.*, correct) reporting had been done, the tax liability in the terminal return would have been greater.

Certain *post mortem* tax planning was carried out that resulted in an amended terminal return being filed within the normal reassessment period. The amended terminal return dealt with a capital loss carryback pursuant to the *post mortem* planning and also disclosed the original reporting error relating to “Victoria Park”, albeit in an incomplete manner. Specifically, the schedule reporting the deemed disposition of “Victoria Park” was corrected to show the corrected capital gain and recapture because it was a direct ownership interest, but the same capital gain was recorded in the amended return itself, as had been recorded in the original return as filed.

After the normal reassessment period expired, CRA reassessed to include the capital gain and recapture resulting from the deemed disposition of the direct ownership interest in “Victoria Park”. The Estate argued that such reassessment was statute barred and in any event, the fact that the recapture had been reported in the schedule to the amended return corrected any misrepresentation in the return as originally filed.

Both the Tax Court of Canada and the Federal Court of Appeal rejected the taxpayer’s position and found that CRA was permitted to reassess outside of the normal reassessment period in the circumstances. The Federal Court of Appeal considered that if the estate trustees had carefully reviewed the terminal return as originally prepared, they would have asked about the reporting of “Victoria Park”, which would in turn have led to the accountants discovering that the recapture had not been reported.

Lewin Estate illustrates what seems to be a relatively low threshold for an Open-ended Reassessment Period. While the nature and circumstances of the error in *Lewin Estate* may make the result of the case somewhat unsurprising, other cases including *Vine Estate* involving subparagraph 152(4)(a)(ii) have turned on the failure to adequately review and ask questions about aspects of the tax return.[37] This means that the wise and prudent estate trustee who is called upon to sign a tax return should carefully review and ask questions, rather than blithely signing.

Reassessment – who

It is well known that an estate trustee should obtain a clearance certificate under subsection 159(2). If the estate trustee distributes property without first having obtained such a certificate, then pursuant to subsection 159(3), the estate trustee is personally liable for the taxes of the estate to the extent of the value of the property distributed. Given that a proposed distribution may be planned prior to the expiry of the normal reassessment period for the terminal return and subsequent estate returns and in any event, given what seems to be a relatively low threshold for an Open-ended Reassessment Period, obtaining a clearance certificate seems prudent.

The issuance of a clearance certificate does not preclude CRA from reassessing the estate, or taking collection action against the estate if there remains any property or pursuing beneficiaries to whom property was distributed.[38]

A beneficiary of an estate to whom property is distributed could be the subject of a cascading section 160 assessment and potentially jointly and severally liable for taxes of the estate or of the deceased for taxation years ended prior to the date of the distribution or the taxation year in which the distribution occurred. Section 160 imposes joint and several liability on a transferor and transferee for the transferor's tax liability where:

- The transferor and transferee are non-arm's length.
- The transferor transferred property to the transferee for less than fair market value consideration.
- The transferor has a tax liability (whether or not assessed) for his/her/its taxation year in which the transfer occurred or a prior taxation year

At first instance, the joint and several liability of the transferee is limited to the excess of the fair market value of the transferred property over the consideration (if any) given for such transfer. However, there is no limitation on the interest which may accrue.

An assessment may be issued pursuant to section 160 "at any time". The concept of the normal reassessment period does not apply. There is effectively no limitation period.

A beneficiary of a trust or estate is deemed to be non-arm's length with the trust or estate.[39] A distribution from the estate to the beneficiary would be a transfer of property, whether in cash or in kind. No consideration passes from the beneficiary. The effect of section 160 is that the beneficiary is jointly and severally liable and may be assessed for tax liability of the estate. This could be tax liability for the estate's taxation year in which the distribution is made, or a prior taxation year of the estate. The fact that the estate trustee may have received a section 159 clearance certificate is irrelevant and no defence for the beneficiary.

Goldberg v. The Queen[40] is an informal procedure decision of the Tax Court of Canada and therefore of no precedential value. However, it illustrates the effect of section 160. David, Sarah, and Rachelle Goldberg were three minor beneficiaries of a family trust of which their father was the sole trustee. The family trust paid school and summer camp fees on their behalf at a time when the trust had been assessed and owed taxes for two prior taxation years. The Court found that there was a transfer of property; there was no consideration, and it upheld the section 160 assessment of the three minor children.

There can be cascading application of section 160 where there are multiple or successive transfers of property among non-arm's length persons. The following is an example assuming that Person A, Person B, and Person C are all non-arm's length and each has a December 31 taxation year end.

- September 2019: Person A transfers property with fair market value of $100,000 to Person B for no consideration.

- January 2020: Person B transfers property with fair market value of $100,000 to Person C for no consideration. This could be the same property or different property.
- June 2021: Person A is reassessed for his 2018 taxation year and has a tax liability of $100,000.

Person A and Person B (who received a transfer of property from Person A) are jointly and severally liable for Person A's tax debt of $100,000. Person B may be assessed pursuant to section 160.

Even if Person B had not been assessed pursuant to section 160 at the time property was transferred to Person C and is not assessed, Person C's liability under section 160 arose as soon as the transfer occurs. Person C may be assessed for the tax debt of $100,000.

Ansems v. The Queen[41] ("*Ansems*") involved a cascading section 160 assessment. Assessments were issued against the Ansems Family Trust (2008) (the "Ansems Trust") and two of its beneficiaries, Randy and Angela. The Ansems Trust was the sole shareholder of a corporation referred to as Holdings. Holdings was the sole shareholder of another corporation referred to as Velsoft. In 2009, Velsoft paid a dividend of $382,100 to Holdings.[42] Between 2009 and 2011, Holdings paid dividends aggregating $479,905 to the Ansems Trust and the Ansems Trust distributed this amount to Randy and Angela ($239,953 each). Velsoft's taxation year ended January 21, 2010 was reassessed and the tax liability was not paid. (Presumably the 2009 dividend from Velsoft to Holdings was within Velsoft's January 21, 2010 taxation year). CRA later assessed Holdings for that tax amount pursuant to section 160 and corresponding cascading section 160 assessments were issued against the Ansems Trust, Randy, and Angela. The decision in the case dealt with the validity of the assessment against Velsoft; if such assessment was not correct then the cascading section 160 assessments would fail. The appeal was unsuccessful.

In the case of the deceased, the estate, and the beneficiaries, all parties should be aware of the potential for section 160 assessments. CRA considers that transfer of property from the deceased to the estate of the deceased do not take place at arm's length.[43] Further, as mentioned previously, an estate and the beneficiaries are deemed to be non-arm's length. A beneficiary therefore could possibly be subject to a section 160 assessment in respect of tax liability of the estate or even the deceased.

IV. Concluding Comments

This paper has commented on only a few income tax issues of which a lawyer working on estate administration should be mindful. As discussed above, income tax issues can arise at the outset; at the time of distribution; and even after all interested parties may believe that the estate has been wound up. While the lawyer will not be involved in preparing the tax returns of either the deceased or the estate, it is prudent to be aware of tax risks to guide the estate trustee(s) and beneficiaries.

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1 Unless otherwise indicated all statutory references herein are to the *Income Tax Act* (Canada), RSC 1985, c.1 (5th Supp.), as amended (the "ITA").

2 See *Fundy Settlement v. The Queen*, 2012 SCC 14.

3 See subsection 248(1), ITA definition of "graduated rate estate". There are other requirements too.

4 See subsection 249(4.1), ITA.

5 Paragraph (b) is an exclusion relating to some trusts created before November 13, 1981 and has been assumed to be irrelevant for purposes of this discussion.

6 97 DTC 1380 (TCC), at paragraph 10.

7 For example, see CRA document no. 2011-0417391E5, June 26, 2012 and 2013-0493671C6, October 11, 2013. See also question 3, 2016 STEP Roundtable.

8 Paragraph 248(8)(a) states:

> "For the purpose of this Act,
>
> (a) a transfer, distribution or acquisition of property under or as a consequence of the terms of the will or other testamentary instrument of a taxpayer or the taxpayer's spouse or common-law partner or as a consequence of the law governing the intestacy of a taxpayer or the taxpayer's spouse or common-law partner shall be considered to be a transfer, distribution or acquisition of the property as a consequence of the death of the taxpayer or the taxpayer's spouse or common-law partner, as the case may be".

9 See question 2, 2008 STEP Roundtable.

10 See subsection 104(24), ITA.

11 For this purpose, a service is stated not to include a transfer or loan of property.

12 Application may be made to the Minister for a longer period but the application must be made within the 12 month period.

13 Similar to the above, application may be made to the Minister for a longer period.

14 See paragraph 251(1)(b), ITA.

15 Based on the legislative history, it appears that in the earlier version of draft legislation that culminated in current definition of "testamentary trust" and in particular, the anti-avoidance rule in paragraph (d) therein did not contain any exception to the Arm's Length Reasonableness Requirement. The Department of Finance released a comfort letter dated April 28, 2004 presumably in response to representations indicating that it would recommend a modification to the Arm's Length Reasonableness Requirement and a portion of such comfort letter is reproduced below:

> "In your letter you have expressed concern that the last condition in subparagraph (d)(iii) of that definition—that the specified party would have been willing to make the payment if the specified party dealt at arm's length with the trust or estate—will, in practice, not be satisfied in the case of the vast majority of estates of deceased individuals. We understand from your letter that this is because of the legal limitations placed on the estate executor's ability to deal with property of the estate, such that family members of a deceased individual will often undertake to make payments on behalf of the estate—for example, the payment of funeral expenses or a tax liability—without any expectation, or arrangement to the effect, that the reimbursement by the estate of such payments include an arm's length amount of interest. As a result, under that proposed paragraph of the definition "testamentary trust" the estate would lose its status under the Act as a testamentary trust.
>
> We are of the view that the loss of an estate's status as a testamentary trust, in these circumstances, would be inconsistent with the policy objectives of proposed paragraph (d) of the definition. Therefore,

> we are prepared to recommend a modification to proposed subparagraph (d)(iii) of the definition "testamentary trust", to provide that the requirement in clause (C) of that subparagraph—that the specified party would have been willing to make the payment if the specified party dealt at arm's length with an individual's estate—not apply where the payment for or on behalf of an estate is made within the first 12 months after the individual's death (or, where written application has been made to the Minister of National Revenue by the estate within that 12 months, within any longer period that that Minister considers reasonable in the circumstances). As a result, where the remaining conditions of proposed subparagraph (d)(iii) of that definition are satisfied, to the extent that the circumstances do not involve an attempt to use the estate as a vehicle for income splitting, the anti-avoidance provisions of the Act would not be expected to apply to cause the estate to lose its status as a testamentary trust."

[16] The non-resident beneficiary should be advised to seek advice in his/her home jurisdiction about the tax consequences of receipt of any distribution.

[17] Pursuant to subsection 116(5), ITA the purchaser may be liable for 25% of its cost of capital property and pursuant to subsection 116(5.3), ITA, 50% of the cost of depreciable property. Accordingly, the percentage which a purchaser may seek to withhold in respect of the purchase price of land is 25% and 50% in respect of the purchase price of building.

[18] SC 2013, c, 12, s. 22(1) applicable in determining after March 4, 2010 whether a property is taxable Canadian property.

[19] Although *Lipson v. The Queen* 2012 DTC 1064 (TCC) ("*Lipson*") held that an estate was not a trust for all purposes of the ITA such that subsection 116(3) reporting did not apply to a distribution from an estate to a non-resident beneficiary, the definition of the term "trust" in subsection 248(1) was amended by S.C. 2013, c. 40, s. 89(1) in force December 12, 2013 to expressly include an estate, unless the context otherwise requires. See discussion of *Lipson* by Chris Falk and Stefanie Morand, "Is an Estate not a Trust for all Purposes of the *Income Tax Act*?" *Tax Topics* no. 2087, March 8, 2012.

[20] See for example, CRA document no. 2015-0578541C6, June 18, 2015.

[21] See paragraph (d) of the definition of the term "disposition" in subsection 248(1), ITA. The two exclusions from paragraph (d) are paragraphs (h) and (i). Paragraph (h) does not apply to a "personal trust", but rather contemplates which is colloquially referred to as a business trust which is unitized. Paragraph (i) refers to distributions of current year income including capital gains.

[22] Joseph Frankovic, "Application of Section 116 to Distributions by Canadian Resident Trusts to Non-Resident Beneficiaries", *Tax Topics* no. 1779, April 13, 2006:

> "On a final note, it is debateable whether the CRA is correct in its assertion that the trust "acquires" the capital interest under these circumstances for purposes of subsection 116(5). This position does not appear to be well-settled as a matter of law. Arguably, what the trustees of the trust "acquire" as a result of the beneficiary's capital interest being extinguished upon the distribution of the TCP is not the capital interest itself, but rather absolution for the legal duty to provide the beneficiary with further capital of the trust in respect of the former capital interest. If this latter interpretation is correct, it would appear that the trust could not be held liable under section 116(5) in any event."

[23] Subsection 116(3), ITA.

[24] "Excluded property" is excluded from subsection 116(1) which imposes the obligation upon a non-resident person to obtain a certificate of compliance. The term "excluded property" is defined in subsection 116(6) and paragraph (i) therein refers to a "treaty exempt property". This is defined in subsection 116(6.1) to mean a "treaty protected property" which in turn is defined in subsection 248(1) to mean property the income or gain from which would be exempt from tax because of a tax treaty.

[25] See section 251, ITA.

[26] *Income Tax Folio* S1-F5-C1, "Related Persons and Dealing at Arm's Length", paragraph 1.49 states:

1.49 Where, in the context, a reference to the trust is to be read to include a reference to the trustee having ownership or control of the trust property, the trust will be related to each person who is related to that trustee.

Example 8

Mr. A is the sole trustee of a particular trust. The trust will be related to, and deemed not to deal at arm's length with, each person to whom Mr. A is connected by blood relationship, marriage or common-law partnership or adoption. This would include, for example, his spouse, his children and other descendants and his brothers and sisters.

[27] Jeffrey T. Love and Kenneth R. Hauser, "How Various Aggregation Rules Apply to Trusts", a paper presented at the 2018 Annual Conference of the Canadian Tax Foundation, at p.28:38-28:49.

[28] See subsection 116(5), ITA on the presumption that the amount of the distribution by the estate trustee (as "purchaser") is the purchase price.

[29] See subsection 227(10.1), ITA.

[30] See subsection 227(9), ITA.

[31] See paragraph 152(3.1)(b), ITA.

[32] 2019 TCC 21.

[33] *Ibid*, at paragraph 8.

[34] See *e.g., Nesbitt v. The Queen* 96 DTC 6588 (FCA), cited *supra,* footnote 3 at paragraph 34.

[35] *Supra*, footnote 3, at paragraph 36 citing *Venne v. The Queen* 84 DTC 6247 (FCTD).

[36] 2015 FCA 125 affirming 2014 TCC 64. See comment by Georgina Tollstam, "Deceased Return Reassessed After Normal Period" (2015) 23:8 *Canadian Tax Highlights* 5.

[37] See Joan E. Jung, "Neglect Is Not Just Unreported Income" (2010) 10:2 *Tax for the Owner-Manager*, 4-5.

[38] See *Boger Estate v. Minister of National Revenue*, 89 DTC 15 (TCC), paragraph 23, affirmed 91 DTC 5506 (FCTD) and 93 DTC 5276 (FCA):

> The clearance certificate is addressed to the responsible representative and any statement by the Minister contained in the certificate is made to the responsible representative with respect to his liability in his personal capacity under the Act. The issue of a clearance certificate does not preclude the Minister from going against a beneficiary to whom property of the estate, for example, was distributed, or if property remains in the hands of the responsible representative, against the responsible representative in such capacity. The obtention of a clearance certificate by a legal representative does not free the Estate from its liability under the Act.

[39] See paragraph 251(1)(b), ITA.

[40] 2003 DTC 190 (TCC). This was an informal procedure decision.

[41] 2019 TCC 66.

[42] Dividends have been held to be a transfer of property for no consideration such that the recipient shareholder may be subject to a section 160 assessment for the dividend paying corporation's tax, assuming that the parties are non-arm's length. See *Algoa Trust v. The Queen* 93 DTC 405 (TCC).

[43] *Supra*, footnote 26, paragraph 1.52.