Practical Matters in Filing Trust & Estate Tax Returns

STEP WINNIPEG

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Commentary included in this presentation includes excerpts from "**Practitioner's Guide to Trusts, Estates and Trust Returns 2006-2007**" [published by Thomson Canada Limited], co-authored by Larry H. Frostiak, FCA, CFP, TEP and John E.S. Poyser, LLB, TEP "Reprinted by permission of Thomson Carswell, a division of Thomson Canada Limited."

Society of Trust and Estate Practitioners

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1. Key Concepts

- Death creates realization of:
  - Gains and losses
  - Accrued Income
  - Reserves
  - Registered Funds
- Exception for “Cross-Generational” transfers to spouse
- Taxation for inter-generational “downstream” transfer

Exception: Rollover to Spouse or Common-law partner

- Deferral of all realizations for qualifying transfers to
  - Spouse / common-law partner
  - Qualifying spouse or common-law partner trust
- Flexibility to "Opt-out" of rollover provisions on an asset-by-asset basis

Terminal Return vs Estate Return

Terminal Returns

- Tax return of deceased taxpayer
- Reporting income earned or accrued to date of death
- Special returns to report income of deceased on separate basis – apart from terminal return
- Income gains, losses realized after death is not taxed on the terminal return(s).

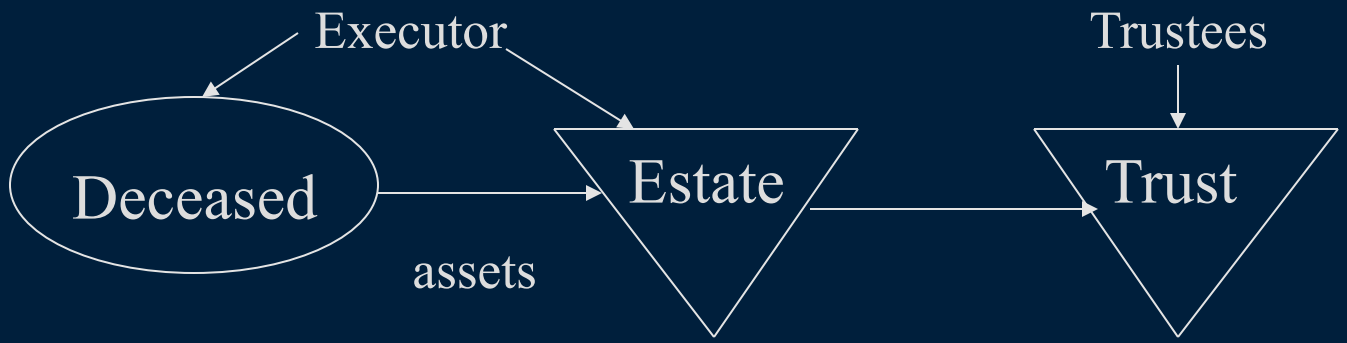
Estate Return

- Has Estate been created?
- Assets vest with Beneficiaries? (Income belongs to Beneficiaries)
- Executor or personal representative holding assets of deceased “In-Trust” for Beneficiaries
- Estate results until assets administered and distributed by executor

Trust Return

- Does will create provision for a trust?
  - Spouse Trust?
  - Children's Trust?
- When does Estate end and Trust commence?

Terminal Return vs Estate vs Trust



Terminal Returns (Income to date of death)	Administration of Estate (Income during Administration)	Capital and Income Beneficiaries
T1 Return(s)	T3 Return	T3 Return

2. Filing Terminal tax Returns

Determining income, deductions and credits

- Employment earnings
- Interest income accrued to date of death
- Pension income (CPP, OAS, Superannuation)
- What about CPP death benefit?
- Annuities
- Business/Partnership income (special rules)
- Unpaid income (accrued vacation pay, declared but unpaid dividends) – special rules
- RRSP income (discussed in detail later)

Determining income, deductions and credits

- Deemed realizations
- Capital gains arising from deemed realizations
  - Mutual funds
  - Segregated funds
  - Publicly traded securities
  - Bonds
  - Real estate (cottage, rental property)
  - U.S. real estate (condo)
  - Listed personal property (LPP)
  - Shares of private corporations (valuation)
  - Principal residence

Determining income, deductions and credits

- Income inclusions
  - Reserves
  - Recaptured CCA on deemed disposition
  - Eligible capital property recapture

Determining income, deductions and credits

- Deductions and credits
  - Non-capital losses
  - Net capital losses
  - Medical expense credit
  - Donation credit
  - $750,000 lifetime capital gains exemption
  - Personal / disability credits

Real Estate

Cottage or Vacation Property

- Deemed disposition at FMV (absent spousal rollover)
- Possible use of principal residence exemption
- Problem – dual or multiple properties
- CRA requirement to designate as PRE Form T2097

Real Estate

Cottage or Vacation Property

Example – Taxpayer deceased in 2008

	Residence	Cottage
# yrs owned inclusive	27	17
FMV		
Acquired 1982	250,000	
Acquired 1992		300,000
ACB	130,000	150,000
GAIN	120,000	150,000

What would you do?

Real Estate

- Cottage or Vacation Property

Designate PRE Wisely

Residence only – cap gain	VS.	$150,000
Cottage only – cap gain		$120,000
Versus		
Residence (1982-1992) $120,000 – (11+1/27 x 120,000) =		66,667
Cottage (1993-2008) $150,000 – (16+1/17 x 150,000) =		NIL
		$66,667

Taxes arising on death

- Income earned until date of death
- Capital gains on deemed realizations
- Reserves included in income-year of death
- Deferral for qualified transfers of property to spouse or spouse trust
- Certain types of income eligible for Elective returns
- Hardship election – pay tax in ten annual instalments (security, interest applies)

Completing the terminal return

- Similar to ordinary T1 return
- Full personal tax credits for short year
- Calculate and apportion investment income
- Accrued and unpaid dividends can be excluded and filed on “Rights or Things” return
- Accrued vacation pay considered a “Rights or Thing”.

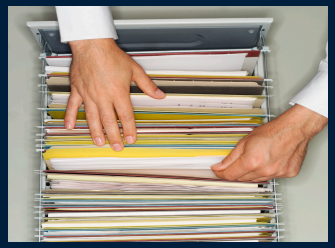
Completing the terminal return

- Donations stipulated in Will constitute a “Will gift” and must be claimed in terminal return or “rights or things” return.
- Donations applied to 100% of net income
- Unused donations CB to prior year
- Executor discretion to gift publicly-traded securities
- Unused non-capital and net-capital losses will expire with terminal return

Completing the terminal return

- $500,000 lifetime capital gains exemption expires on death
- Consider deemed realization to utilize CGE
- Other deductions similar to ordinary T1 return
- Executor can make RRSP contribution for deceased within normal deadlines for contribution
- Executor and related legal costs are not deductible on terminal return

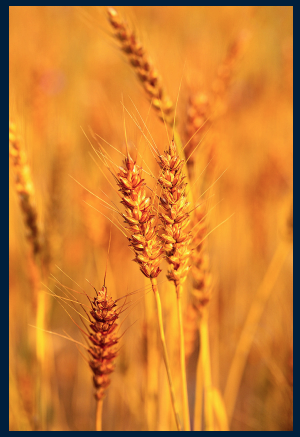
Elective Returns



i. Rights or things
   - Separate tax return Sec 70(1)
   - Separate taxpayer status
   - Progressive tax rates
   - Income-splitting advantage
   - Multiple access to credits (Basic personal amount, age credit, spouse credit, etc.)

Elective Returns

- Income that qualifies
  - Accrued vacation pay
  - Dividends declared and receivable at death
  - Farm crops (cash basis inventory)
  - Accounts receivable for cash basis farmers/fishers
  - Unpaid commissions
  - CPP benefits owing and not received
  - WIP of unincorporated professional
  - Unpaid retiring allowance entitlement



i. Rights or things (cont'd)

- FMV of "right or thing" included in income, not face amount
- Example: Doubtful receivable – FMV may be NIL
- Full personal credits available
- Can elect to claim medical expenses, donations as opposed to terminal return if beneficial

ii. Death of proprietor or partner return

- Separate tax return Sec 150(4)
- Separate taxpayer status
- Progressive tax rates
- Full personal credits available
- Income-splitting advantage
- Income that qualifies
  - Business income earned after close of fiscal period and before end of calendar year ("stub year"). OR
  - Non-calendar year "alternative method" business income creating a second fiscal period end to date of death.

ii. Death of proprietor or partner return

Example 1 “stub year”

- Taxpayer dies on June 30, 2008
- Normal fiscal year ends on December 31
- Profits from Jan 1 – June 30, 2008 can be reported on separate 150(4) income tax return

ii. Death of proprietor or partner return

Example 2 “Alternative method” fiscal period

- Taxpayer dies on June 30, 2008
- Normal fiscal year ends on January 31
- Income for 12 months ended January 31, 2008 included on terminal return
- Prescribed additions/deductions for “alternative method continue to apply”
- Separate 150(4) Return for fiscal period of Feb 1/08 to June 30/08

ii. Death of proprietor or partner return

Example 2 "Alternative method" fiscal period

Business income for YE Jan 31, 2007	$120,000
Business income for YE Jan 31, 2008	140,000
Business income for period ended June 30, 2008	80,000
Particular period defined to be Feb 1 – June 30/08	150 days
Total number of days individual carries on business that are in fiscal periods of the business	
Jan 31/08 YE	365
June 30/08 YE	150
	515

Example 2 (cont'd)

a) T1 Terminal return – 2008

Business income – Jan 31/08	140,000
34.1(3) deduction for 2007 prescribed addition ($120,000 x 334/365)	(109,808)
34.1(1) prescribed addition for 2008 ($140,000 x 150/515)	40,777
	70,969

b) Sec 150(4) Return

Business income to June 30, 2008	80,000
34.1(3) deduction	(40,777)
	39,223
	$110,192

Example 2 (cont'd)

Proof:

Income earned

Jan 31, 2008 YE	$140,000
June 30, 2008 YE	80,000
Deduction under 34.1(3) for 2007 addition	(109,808)
	$110,192

iii. Beneficiary of Testamentary Trust Return

- Applicable only where a trust has a non-calendar year
- Available where deceased was a beneficiary of a testamentary trust
- Income from end of trust's last fiscal period to date of death can be excluded from terminal return
- Income deemed to accrue in "equal daily amounts"
- Election under 70(1) to file separate return and include as only item of income.

iii. Beneficiary of Testamentary Trust Return

Example

- Taxpayer dies on October 31, 2008
- Taxpayer income beneficiary of testamentary trust with May 31 fiscal period
- Income designated to May 31, 2008 $24,000
- Income earned to May 31, 2009 $30,000
- Income deemed to accrue to date of death
  - June 1 – Oct 31/08 153 days
  - $30,000 x 153/365 $12,575
  - Income reportable – terminal T1 $24,000
  - Income reportable – 2008 70(1) Return $12,575

3. Elective Designations

- Opting out of the rollover provisions
- Deductions and reserves
- RRSP contribution in year of death
- Joint elections with legal representative (RRSP section)

Opting out of the rollover provisions

- Legal representative of deceased taxpayer can elect under 70(6.2)
- Asset by asset basis
- Asset deemed to be disposed of at FMV
- Not able to designate amount between ACB and FMV
- Why?
  - Utilize non-capital or net capital losses
  - $750,000 lifetime capital gains exemption
  - Unused donation credits
- Election made in terminal T1 return

Deductions and Reserves

- In year of death, no deduction allowed for reserves against
  - Capital gains
  - Proceeds on sale of resource properties
  - Instalment sale proceeds
  - Bad debts or doubtful accounts
  - Commission income of insurance agents or brokers

UNLESS

- Related property transferred to deceased's spouse or common-law spouse or to a special trust for such partner
- File Form T2069 "Election in Respect of Amounts Not Deductible as Reserves for the Year of Death".

RRSP Contribution in Year of Death

- Final contribution to spousal RRSP
- Contribution made by legal representative of deceased within 60 days after end of calendar year in which taxpayer deceased
- Earned income in year of death not eligible for RRSP contribution room

RRSP Contribution in Year of Death (cont'd)

- Deductible RRSP contribution to spousal plan also available for year where
  - Taxpayer dies in 60 day stub period following calendar year
  - Deductible for year preceding death
  - Earnings for year preceding death qualify as RRSP room for deduction in year of death

RRSP Contribution in Year of Death (cont'd)

- Example

	Income	RRSP Limit
2007 earned income	$75,000	13,500
2008 earned income	80,000	14,400
Date of death	Feb 14, 2009	
2009 stub year income	$45,000	

  - Legal representative can contribute $13,500 by March 1, 2009 and deduct in 2008 AND
    $14,400 by Mar 1, 2009 and deduct in 2009
    OR
    $27,900 by Mar 1, 2009 and deduct all in 2008

Taxation of RRSPs on Death

How is an RRSP taxed on death?

General rules:

- Annuitant deemed to receive RRSP in year of death equal to FMV of property in plan at date of death
- Income inclusion to deceased can be reduced where amounts are paid to annuitant's spouse or financially dependent children or grandchildren

Refund of premiums defined under 146(1) to be:

- Any amount receivable and paid to a spouse for an unmatured RRSP as a consequence of the death of the annuitant; and
- Any amount paid for a matured or unmatured RRSP to a financially dependent “child” where the annuitant died after 1998. [Income Test = Basic Personal Amount].

Refund of premiums:

- Must be paid as a lump-sum payment
- Deduction allowed to deceased for a "refund of premiums" paid to a spouse or financially dependent "child".
- Deduction could be less than amount included in deceased's annuitant's income if RRSP property deceased in value before it was distributed to beneficiary as a "refund of premiums."
- Deduction cannot exceed income inclusion
- Payment included in spouse's income under 146(8).

Matured RRSP

- Where spouse designated as a beneficiary for annuitant's matured RRSP, value of the property in the plan reduces the amount deemed to be received by the annuitant on death.
- Any payments received by the spouse under the matured RRSP are taxable to the spouse

Matured RRSP

- Where the "estate" is designated as beneficiary for annuitant's matured RRSP, legal representative can make the following election:
  - Joint election between spouse and legal representative which deems spouse to become the annuitant
  - Amounts otherwise taxable to the deceased on death (terminal return) deemed to be received by spouse and includable in spouse's income under 146(8)
  - Spouse permitted rollover under 60(l) to RRSP

Rollover provisions

- Spouse who receives a "refund of premiums" can transfer all or part of RRSP property under 60(l) and deduct amount from income
- Must be paid into spouse's RRSP within year or 60 days after the end of the year
- Contribution must be paid as
  - i. A premium under an RRSP where spouse is under 69 years of age; or
  - ii. A payment to acquire a life annuity for spouse; or
  - iii. A payment to acquire an annuity for term to age 90 to the spouse; or
  - iv. A payment as consideration for a RRIF under which the spouse is annuitant

Example 1 – Unmatured RRSP / Spouse designated

- Taxpayer dies (age 68) unmatured RRSP
- Surviving spouse designated as beneficiary
- FMV of RRSP (date of death) $400,000
- FMV of RRSP paid into spouse's plan $400,000

Example 1 – Calculations

	Taxpayer	Spouse
Amount included in income	$	$
- on death 146(8.8)	400,000	
- deemed inclusion 146(8)		400,000
Deduction for amount paid		
- to spouse 146(8.9)	(400,000)	
- to spouse's RRSP 60(l)		(400,000)
	NIL	NIL

Example 2 – Unmatured RRSP – estate as beneficiary

- Taxpayer dies (age 68) unmatured RRSP
- Surviving spouse NOT designated as beneficiary
- FMV of RRSP (date of death) $400,000
- FMV of RRSP (when transferred to spouse) $390,000

Example 2 – Calculations

	Taxpayer	Spouse
Amount included in income	$	$
- on death 146(8.8)	400,000	
- deemed inclusion 146(8)		390,000
Deduction for amount deemed as "refund of premiums"		
- joint election 146(8.1)	(390,000)	
- transfer to spouse's RRSP under 60(l)		(390,000)
	$10,000	NIL

Example 3 – Matured RRSP / Spouse designated

- Taxpayer dies (age 79) – matured RRSP
- Surviving spouse designated as beneficiary to receive benefits
- FMV of RRSP (date of death) $400,000

	Taxpayer	Spouse
Amount included in income	**$**	**$**
- on death 146(8.8)(a)	**400,000**	
Exceeds		
FMV of plan receivable by spouse 146(8.8)(b)	**(400,000)**	
	0	**0**

Example 4 – matured RRSP / estate as beneficiary

- Taxpayer dies (age 79) – matured RRSP
- Surviving spouse NOT designated
- FMV of RRSP (date of death) $400,000
- Joint election under 146(8.91)

Example 4 – Calculations

	Taxpayer	Spouse
Amount included in income	$	$
- on death 146(8.8)(a)	400,000	0
Exceeds		
FMV of plan receivable by spouse 146(8.8)(b)	0	0
	400,000	0
146(8.91) joint election deems proceeds receivable	(400,000)	0
	0	0

4. Filing Deadlines

1. Terminal Return

Later of

April 30th following year of death

and

6 months after date of death

2. Rights or Things

Later of

One (1) year from date of death

and

90 days after assessment date of ordinary terminal return

3. Proprietor or Partner Income Tax Return

Later of

6 months after date of death

and

June 15th following year of death

4. Beneficiary of Testamentary Trust Return

Later of

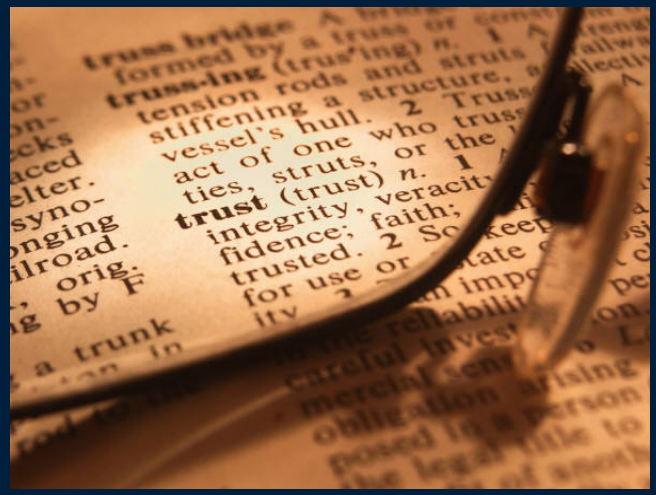
6 months after date of death

and

April 30th following year of death

5. TRUSTS vs ESTATE

- Trust is not the same as an estate
- “Division of ownership” issue!



Trusts vs. Estate (cont'd)

- Beneficiary of trust holds equitable interest and trustee holds legal title
- Beneficiary of estate does not necessarily enjoy a beneficial interest in the assets while under administration and part of the estate

Trusts vs. Estate

Where will contemplates creation of trust with some or all of the assets of the estate, a question can arise as to when the estate terminates and the trust commences.

When does an estate not become a trust?

- Property of deceased owned jointly with other persons
- Property passes directly by beneficiary designations

6. Trust Returns For Estates

When is there a requirement for an estate to file a trust return (T3 Return)?

- Tax payable on income earned after the date of death
- Disposed or deemed to dispose of capital property
- Non-resident trust disposing of taxable Canadian property
- Deemed resident trust
- Holds property subject to subsection 75(2)
- Provided a benefit of more than $100 to a beneficiary for upkeep, maintenance, taxes of a property maintained for the beneficiary's use and enjoyment
- Earns income allocated to a beneficiary

Determining Income, Deductions and Credits

- Income Inclusions
  - Line 01 – Taxable Capital Gains – Sched 1
    - – Reserve for Proceeds Not Due

Determining Income, Deductions and Credits

Line 02 – Pension Income

Line 03 – Actual Amount of Dividends from Taxable Canadian Corporations

Determining Income, Deductions and Credits

Line 04 –
Foreign Investment Income – Schedule 8

Line 05 –
Other Investment Income – Schedule 8

Determining Income, Deductions and Credits

Line 06 –
Business Income – T2124

Determining Income, Deductions and Credits

Line 07 – Farming Income T1164

Line 08 – Fishing Income T2121

Determining Income, Deductions and Credits

Line 09 – Rental Income – T776

Income – Account for on "Accrual Basis"

DEDUCTIBLE EXPENSES

- Property taxes (exception for vacant property)
- Insurance
- Utilities
- Repairs and maintenance (except major renovations of capital nature)
- Advertising
- Interest
- Salaries, wages
- Commissions paid to agents to collect rent
- Office supplies
- Accounting and legal

Determining Income, Deductions and Credits

DEDUCTIONS

Line 21 – Carrying charges and Interest Expenses – Schedule 8

Eligible deductions:

- Interest on borrowed funds
- Management fees
- Safe custody
- Accounting fees
- Investment counsel fees

Determining Income, Deductions and Credits

Line 24 – Trustee Fees Deductible from Income

- Must relate to earning of income
- Paid to Executor or Trustee whose principal business is such services

Determining Income, Deductions and Credits

Line 25 – Allowable Business Investment Loss (ABIL)

- ABIL – arises where trust holds investment in shares or debt of a SBC
- Shares – disposition to arm's length person or corporation formally bankrupt or insolvent
- Debt – disposition to arm's length person or debt deemed uncollectible under Paragraph 50(1)(a).

Determining Income, Deductions and Credits

Line 44 – Value of other Benefits to a Beneficiary

Line 47 – Total Income Allocations and Designation to Beneficiaries

Determining Income, Deductions and Credits

Line 49 – Gross-Up Amount of Dividends Retained or Not Designated by the Trust

- Retain dividend income within trust
- Taxed within trust
- Gross-Up and Dividend Tax Credit applies

Determining Income, Deductions and Credits

Line 51 – Non-Capital Losses of Other Years

- Application any other source of income
- Can arise from:
  - Business or property
  - Unutilized portion of ABIL
- Account for losses by taxation year

Request for Loss Carryback by a Trust – T3A

- File T3A separately or with current year T3 Return

Line 52 – Net Capital Losses of Other Years

Application:

- Deducted only against capital gains retained and taxed within trust
- Loss determined on “net basis”
- Cannot exceed taxable capital gains entered on line 01 for taxation year.

Line 53 – Capital Gains Deductions for Resident Spousal or Common-Law Partner Trust Only – Schedule 5

- Available Deduction is:

  $250,000 less amounts claimed in prior taxation years

Line 54 – Other Deductions to Arrive at Taxable Income

Available deductions:

- Foreign income exempt from tax due to treaty or convention
- Limited partnership losses from a prior year attributing to estate or trust
- Farming or Fishing losses of a prior taxation year

Completing the T3 Information Return

CRA Question 1

Is the trust one of a number of trusts created from contributions by the same individual? If yes, complete Schedule 6 and attach a list of the names, addresses, and account numbers of the other trusts.

Issues

- Multiple trusts
- Taxed together as a single trust

Completing the T3 Information Return

CRA Question 2

For any trust (other than a unit trust) did the ownership of capital or income interests change since 1984? If yes, the year, and if during this taxation year, attach a statement showing the changes.

Issues

- Taxable disposition may result from a change of beneficial ownership
- Trust or estate may realize a disposition of property

Completing the T3 Information Return

CRA Question 3

Were the terms of the trust amended or varied since June 18, 1971? If yes, state the year, and if during this taxation year, attach copies of the documents effecting these changes.

Issues

- Generally relevant for pre-June 18, 1971 inter vivos trusts
- Amendments could "taint" the trust or trigger a disposition of trust's assets.

Completing the T3 Information Return

CRA Question 4

Has the trust continuously resided in Canada since it was established (or since June 18, 1971, if it was established before that date)?

Issues

- Ceasing to be resident results in deemed disposition of all trust assets at FMV
- File Form T1161

Completing the T3 Information Return

CRA Question 5

Did the trust receive any additional capital property by way of a gift since June 18, 1971? (Do not include the original property settled on the trust.) If yes, state the year, and if during this taxation year, attach a statement giving details.

Issues

- Loss of testamentary status
- Transfer or "Gift" of capital vs purchase at FMV

Completing the T3 Information Return

CRA Question 6

Did the trust borrow money or incur a debt in a non-arm's length transaction since June 18, 1971? If yes, state the year, and if during this taxation year, attach a statement showing the amount of the loan, the lender's name and the lender's relationship to the beneficiaries.

Issues

- Loss of favorable tax treatment for pre-June 11, 1971 inter vivos trusts
- Discharge debt within a "reasonable time" or face loss of favorable tax status

Completing the T3 Information Return

CRA Question 7

In any previous taxation year, did the trust use Form T1015 to elect to defer the deemed realization day?

Issues

- Deemed realization of assets at January 1, 1999
- Where election made to defer realization for pre-1972 spouse trust, no access to unused portion of spouse's lifetime capital gains deduction

Completing the T3 Information Return

CRA Question 8

Does the will, trust document, or court order require the payment of trust income earned in the current year to beneficiaries? If yes, complete Schedule 9.

Issues

- Income of trust taxable to beneficiaries
- Such income that is payable to a beneficiary is deductible from the trust's income
- 104(13.1) and 104(13.2) designations?

Completing the T3 Information Return

CRA Question 9

Did the trust receive, after December 17, 1999, any property as a transfer from a non-grandfathered inter vivos trust where the beneficial ownership of property did not change as a result of the transfer? If yes, state the year, and if during this taxation year, attach a statement giving detail.

Issues

- Deemed realization
- Transfers between two trusts of the same type does not automatically create a deemed realization

Completing the T3 Information Return

CRA Question 10

Did the trust distribute assets other than cash to a beneficiary during the taxation year? If yes, attach a statement giving a complete description of the property, the name and address of the beneficiary to whom the property was distributed, and the date the property was distributed. If the beneficiary is an individual, also state the beneficiary's social insurance number.

Issues

- Distribution of property in kind?
- Deemed disposition to trust?
- Statement detailing particulars of distribution to beneficiary

Completing the T3 Information Return

CRA Question 11

Did the trust receive any additional property by way of a contribution of property (as defined in the Glossary of the guide since June 22, 2000? If yes, state the year and, if during this taxation year, attach a statement giving details.

Issues

- Contribution of property to a non-resident trust
- Sec 94 and Foreign Accrual Property Income (FAPI) rules

7. Filing Deadlines

T3 Return – 90 days after taxation year

T3 and NR4 Supplementaries – 90 days after taxation year

8. Clearance Certificate

- Personal representative should obtain Clearance Certificate from CRA prior to distributing property to beneficiaries
- All returns must be filed and assessed

  Terminal returns TX19

Clearance Certificates

For an Estate

- Plan of distribution of assets
- Select a “chosen date”
- Complete Form TX21 (Estate)

Questions?

Thank-you!

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