

ARE TRUSTS DEAD? (OR MORTALLY WOUNDED?)

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To the Winnipeg Estate Planning Council

Monday, March 2, 2020

ARE TRUSTS DEAD? (OR MORTALLY WOUNDED?)

AGENDA

- 1. The New Compliance Rules**
- 2. Some Welcome Changes with Trusts**
- 3. Some Reasons to Wind Them Up**
- 4. How to Wind Them Up**

ARE TRUSTS DEAD? (OR MORTALLY WOUNDED?)

1. The New Compliance Rules

- Tax Authorities wanting more “transparency”
- Information on who controls the trust and...
- Who are the beneficial owners
- New Federal disclosure rules coming
- BC also released some new rules

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1. The New Compliance Rules

BC Government

- Starting in May 2020
- Private businesses will be required to maintain “transparency records”
- Disclosure required for “people or entities” with direct or indirect control of the company or its shares

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1. The New Compliance Rules

BC Government

- Amendments to the BC Business Corporations Act
- Requirement to disclosure direct/indirect owners:
 - Full legal name
 - Date of Birth
 - Citizenship information
 - Last known address
- Applies to ownership through numbered companies, offshore and domestic trusts

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1. The New Compliance Rules

Federal Changes to Trust Reporting

- Applicable for trusts with taxation years ending after December 30, 2021
- Will generally apply for trusts with 2021 calendar year-ends
- New reporting and disclosure requirements

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1. The New Compliance Rules

Federal Changes to Trust Reporting - New Provisions

- Trust may need to file – even where no income tax payable
- Subsection 150(1.1) currently exempts filing requirement where no tax payable
- New subsection 150(1.2) will make 150(1.1) inapplicable for certain trusts

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1. The New Compliance Rules

Federal Changes to Trust Reporting - New Subsection 150(1.2)

- Applies to trust resident in Canada that is an express trust
- The phrase “express trust” is not explicitly defined in legislation
- So what is an “express trust”?

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1. The New Compliance Rules

Federal Changes to Trust Reporting - Express Trust

- Conceptually, it includes:
 - Trusts created deliberately; and
 - Trusts created by court order
- But...what about “bare trusts”? Is a “bare trust” an “express trust”?

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1. The New Compliance Rules

Federal Changes to Trust Reporting - Bare Trust

- Would appear to be an “express trust” – (created by intention or legal document)

BUT...

- Subsection 104(1) except bare trusts from the new reporting rules
- May not apply for B.C. Resident Trust

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1. The New Compliance Rules

Federal Changes to Trust Reporting - Other Exceptions

- Subsection 150(1.2) contains a long list of certain trusts that will be exempt from the new reporting rules
 - Trusts in existence for less than 3 months at the end of the year
 - Trusts with assets of less than \$50K FMV throughout the year, with various types of cash or near-cash assets
 - Certain lawyers' trust accounts
 - Registered trust accounts (TFSA's, RRSP's, RRIF's)
 - Graduated Rate Estates (GRE's)

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1. The New Compliance Rules

Federal Changes to Trust Reporting - Other Exceptions (cont'd)

- Registered charities
- Mutual Fund Trusts
- Certain other exceptions

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1. The New Compliance Rules

Federal Changes to Trust Reporting - What needs to be reported?

- **New subsection 204.2(i) will require disclosure on:**
 - Name, address, date of birth, jurisdiction of residence, SIN or BN of:
 - Settlor;
 - Trustee(s);
 - Beneficiary(s); or
 - Person with influence over trustee (protector)

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1. The New Compliance Rules

Federal Changes to Trust Reporting - What are the reporting issues?

- How do you report contingent beneficiaries? Class of beneficiaries?
- For instance...children of Mr. and Mrs. X
- Requirement to disclose met if identities of relevant parties are ascertained with reasonable effort

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1. The New Compliance Rules

Federal Changes to Trust Reporting - Penalties

- Normal penalties under 162(7) can apply - \$25/day to max of \$2,500
- If knowingly or with gross negligence, or failure to comply with a demand by CRA to disclose...
- Then proposed subsections 163(5) and (6) will apply and penalty will be greater of
 - \$2,500; or
 - 5% of highest value FMV of trust property in year
- Penalty could apply to more than one person for the same trust (i.e. – multiple trustees)

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1. The New Compliance Rules

Federal Changes to Trust Reporting - GET READY

- Build good working paper files, financial statements
- Have current trust documentation on file
- Two more filing seasons to get ready....2019 and 2020

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

- October 3, 2016 amendments “softened” with Bill C-63, introduced on October 27, 2017
- Definition of “principal residence” amended to include new subparagraph 54(2)(C.1)(111.1) for a trust that is an “eligible trust”...and that is...
 - One of the beneficiaries is a specified beneficiary; and
 - Resident in Canada for the relevant year

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

- Bill C-63 provides relief for trusts arising as a consequence of death, and
 - Settled by parent for a minor, on death of either the mother or father of the child
 - Property will continue to qualify for the PRE

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

- Bill C-63 drops rule requiring terms of trust to provide specified beneficiary with a right to use the property
- This change widens the ability to designate a gain and claim the PRE

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

For dispositions after 2016, 2 main conditions to meet, to claim the PRE

- At least one of the trust’s beneficiaries must be resident in Canada during year, and be a specified beneficiary
- Trust must qualify as an “eligible trust” – I.E.:
 - Alter ego, spousal or common-law partner trust joint spousal or common-law partner trust, or a life-interest trust
 - Testamentary trust that is a QDT
 - Inter Vivos or Testamentary Trust where settlor died before start of year

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

- Cottage Trust and Estate Planning on Death

- Transfer cottage to inter vivos trust? Use PRE?
- Can keep cottage outside estate on death
- Provide a means to pass use and ownership to next generation
- PRE still available for an “eligible trust” – i.e. Settlor dies before start of year
- 21 year rule to consider

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2. Some Welcome Changes With Trusts

The Principal Residence Exemption (“PRE”) and Trusts

- Cottage Trust and Tax Planning

- Transfer cottage instead to joint partner trust
- No capital gain reported when property inserted
- Capital gain deferred until last-to-die of parent or grandparent making transfer
- PRE could be utilized on last-to-die
- Trust could distribute out cottage to contingent beneficiaries on last-to-die

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3. Some Reasons To Wind Them Up

- 21 year anniversary close
- Trust holds a principal residence or cottage
 - Intervivos trust not excluded (i.e. typical cottage trust)
 - TOSI applies
 - Direct ownership test not met; or
 - Specified individuals would be caught

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3. How to Wind Them Up?

- Direct 107(2) distribution to one or more residual capital beneficiaries
- Beneficiary must be a resident Canadian
- Distribution made in consideration for residual capital interest
- Tax-free roll-out

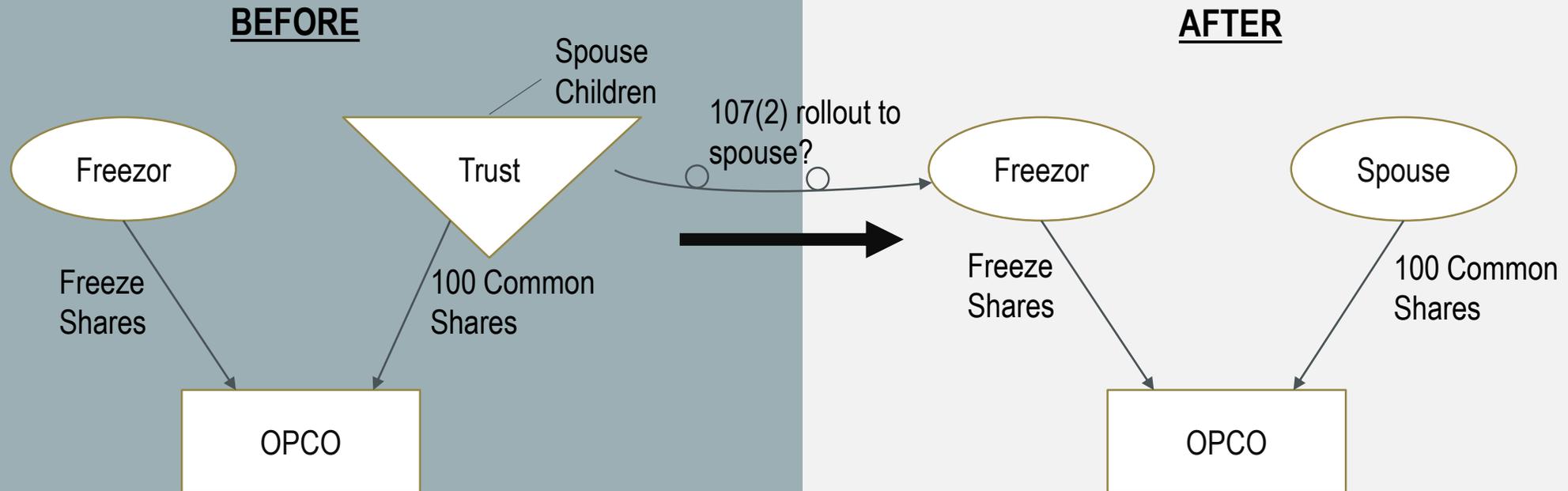
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3. How to Wind Them Up?

- Must be a personal trust
- If 75(2) applied...then no roll-out
- Considerations on “roll-out”
 - Impact on freezor
 - Control of the corporation
 - Freezor’s future liquidity of freeze shares
 - Family equalization

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3. How to Wind Them Up? - Example 1



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3. How to Wind Them Up? - Example 1 (cont'd)

Issues:

- Decision made to distribute only to spouse only for income-splitting and TOSI planning? (i.e. excluded share test)?
- All capital growth ultimately taxable to spouse (not moved downstream to next generation)

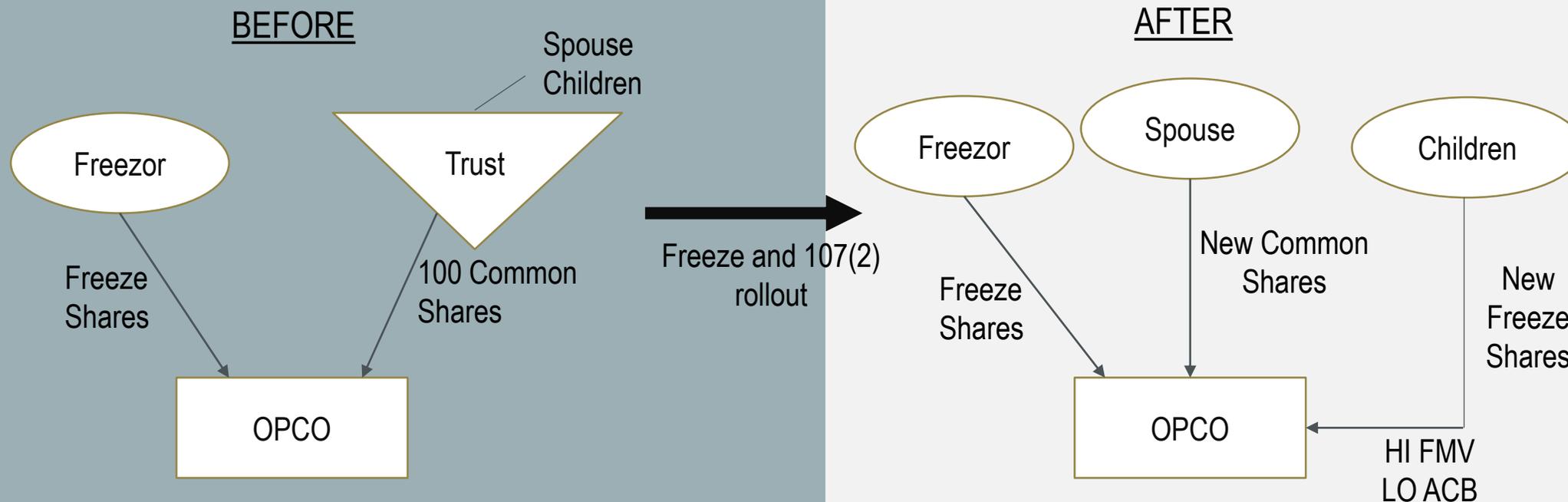
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3. How to Wind Them Up? - Example 1 (cont'd)

- Are you effectively “undoing” the transition to the children
- If you distribute to the children, are they “ready” for common share ownership?
- Forfeiting access to LCGE with children (Is this important?)
- Perhaps distribution to spouse and children? (see next table)

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How to Wind Them up? – Example 2



1. Freeze growth of common held by Trust
2. Distribute freeze shares to children to access LCGE

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3. How to Wind Them Up? - Example 2 (cont'd)

Issues:

- Pre-distribution reorganization required
- Consider crystallizing LCGE?
- Who owns common? Who owns freeze shares?
- Could children force redemption of preference shares-liquidity/cash flow
- What if creditors seized these shares?

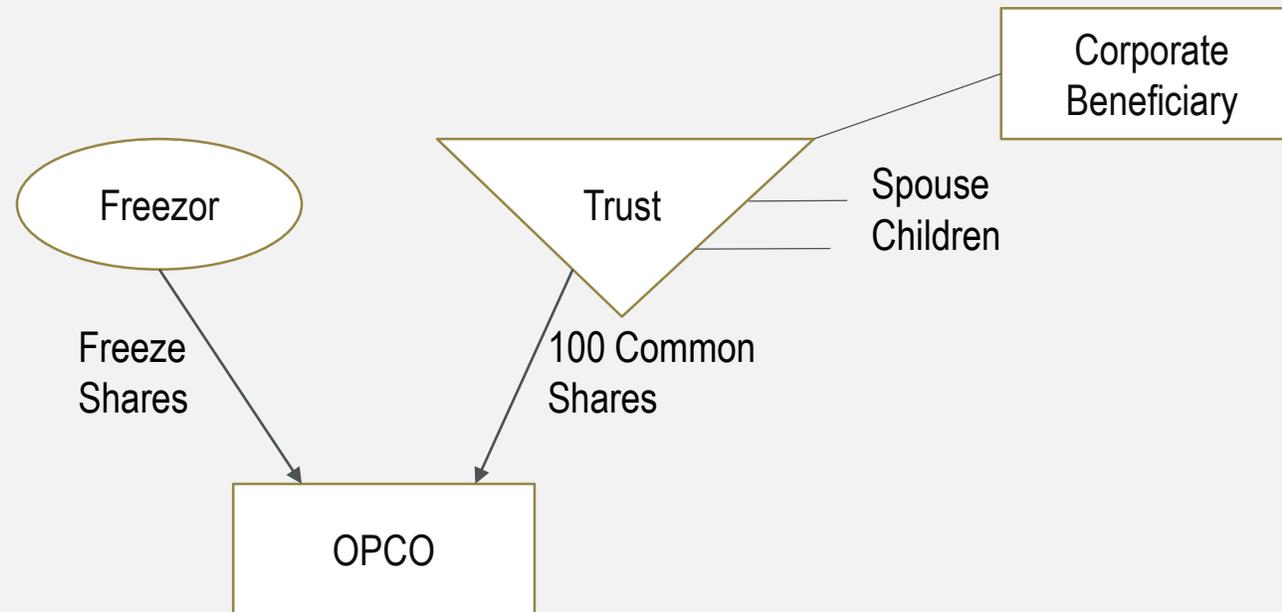
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3. How to Wind Them Up? - Example 2 (cont'd)

- Children hold High FMV Pref shares, eligible for LCGE
 - preserve transfer of value on initial freeze
- Spouse (and possibly freezor?) could own new common shares
- Some creditor/relationship risk with shares held by children

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3. How to Wind Them Up? - Example 3



- Distribute property to corporate beneficiary?

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3. How to Wind Them Up? - Example 3 (cont'd)

Issues:

- Forego LCGE with distribution to corporate beneficiary
- For older trusts...not uncommon for corporate beneficiary to be left out of class of beneficiaries entitled to residual capital
- Who owns shares of “corporate beneficiary”?
- Introduce spouse/children before 107(2) rollout?

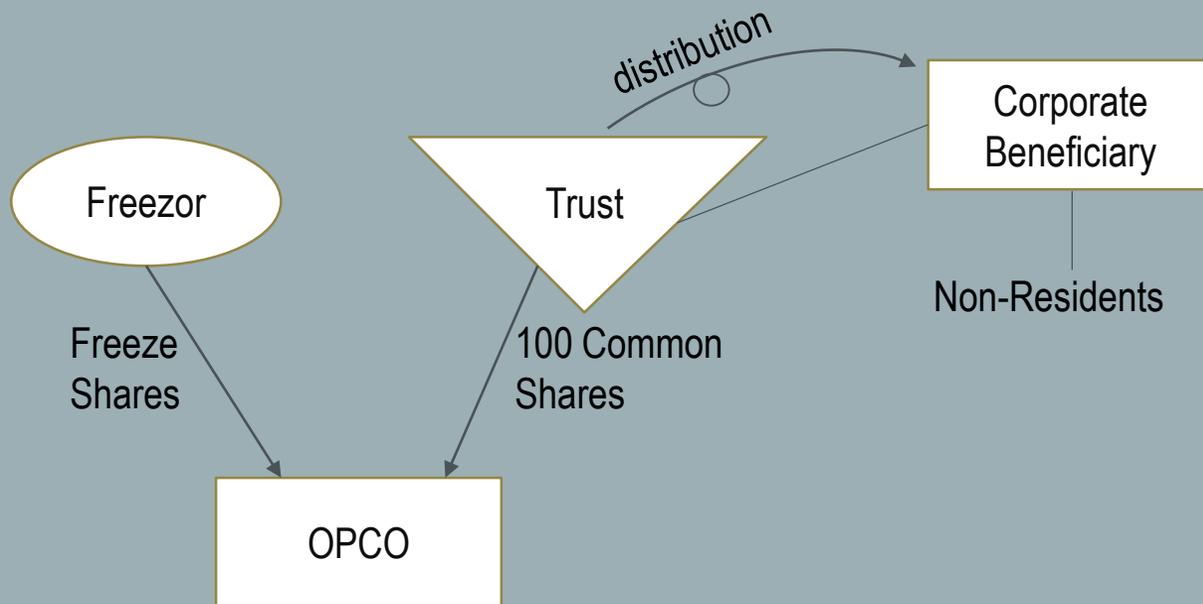
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3. How to Wind Them Up? - Example 3 (cont'd)

- What if non-resident beneficiaries?
- Distributions taxable under 107(5); no tax deferred roll-out under 107(2)
- Could 107(4.1) apply to deny roll-out under 107(2)?
- If 75(2) potentially ever applied, 107(4.1) could apply to deny 107(2)

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3. How to Wind Them Up? - Example 3



- Distribution of appreciated capital property
- What if trust distributes to Cdn Resident Corp? (beneficiary) under 107(2)?
- Corp owned by non-residents
- Tax-deferred roll-out?

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- **Tax Issues**

- CRA comments at CTF conference – November 21, 2017
- CRA expressed concerns that
 - Capital gain could be indefinitely postponed
 - Defeated intent of 107(5) which exists to tax accrued gains on trust property
 - Could GAAR apply?
- Planning for non-resident beneficiaries now somewhat “muddied” in view of CRA comments

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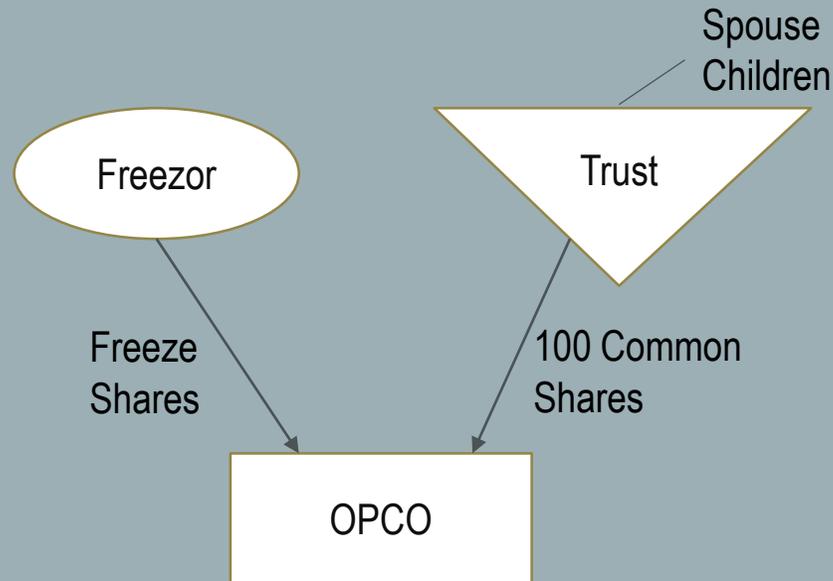
3. How to Wind Them Up? - Example 4

- Utilize a Sec 84.1 surplus strip to “cash-out” on trust value
- OPCO freezes common shares held by Trust
- Trust distributes shares to beneficiaries
- Are these “excluded shares”?
- Beneficiaries sell shares to “Freezor” at FMV for P-Note/full consideration
- Capital gain realized and Trust wound up
- Freezor sells new freeze shares of OPCO to NEWCO for P-Note of NEWCO and subscribes for new common in OPCO

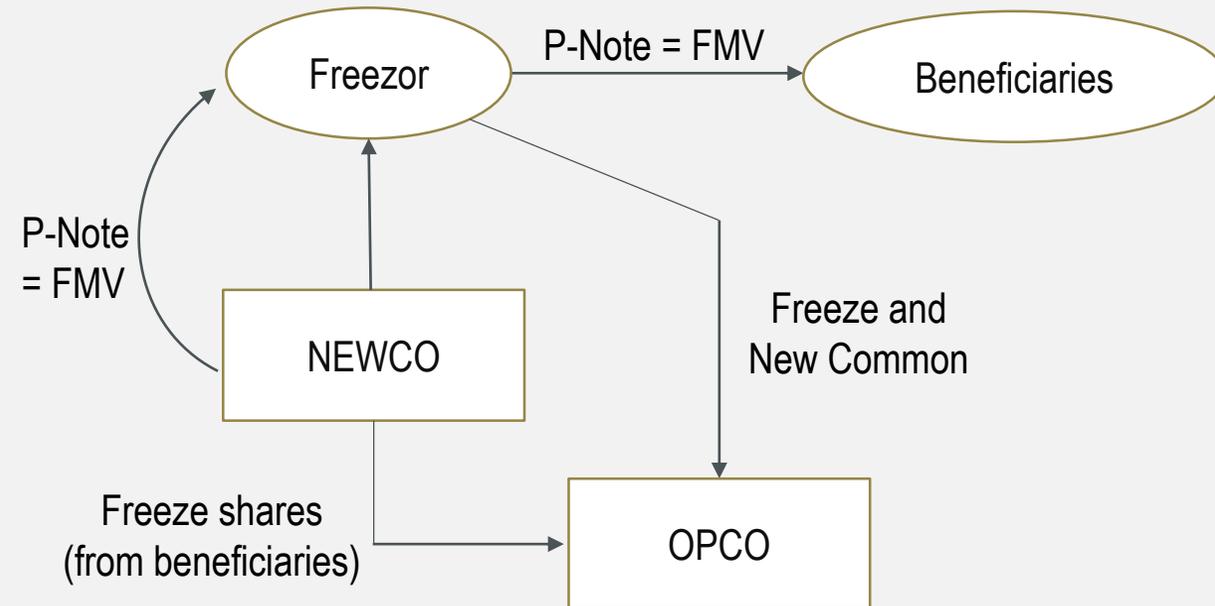
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3. How to Wind Them Up? - Example 4

BEFORE



AFTER



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3. How to Wind Them Up? - Example 4 (cont'd)

- Capital gains realized by individual beneficiaries
- Would TOSI apply or is excluded share test met?
- Possible to access cap gains rates?

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3. How to Wind Them Up? - Example 4 (cont'd)

What has been accomplished?

- Capital gain triggered on FMV of shares held by Trust
- Capital gains rate accessed v. Dividend rates
- OPCO can re-purchase its freeze shares held by NEWCO (tax-free inter-corporate dividend)
- NEWCO can repay P-Note to Freezor (with Cash)
- Freezor can re-pay P-notes to beneficiaries
- AND...the Trust is **GONE**

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- **Other Considerations**

- Valuation issues on a re-freeze
- Consider creating agreements to help beneficiaries manage distributed property
- Control issues/stay with initial freezor ?
- Provisions/agreements for family law and family property matters
- Treating family members/beneficiaries fairly

QUESTIONS?

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THANK YOU!