***Canadian Tax Principles, 2022-2023* (Byrd/Chen)**

**Chapter 19 Trusts and Estate Planning**

19.1 Online Exercises

1) The three types of persons who are associated with a trust are usually described as the settlor, the trustee, and the beneficiary. Briefly describe the role of these persons with respect to the trust.

Answer: The roles of these persons can be described as follows:

• The settlor is the person who contributes property to the trust.

• The trustee is the person who takes legal title to the contributed property and administers and manages the trust as set out by the terms of the trust agreement. This would normally include the selection of investments as well as implementing other provisions of the trust agreement (e.g., distributions to beneficiaries).

• A beneficiary is a person who is entitled to receive distributions of income or capital of the trust as a result of a beneficial interest in the trust property.

Type: ES

Topic: Trusts - definition & characteristics

2) The text notes that it is, in general, difficult to revoke or vary a trust. What is the importance of this characteristic?

Answer: This characteristic is of particular importance in the case of deceased individuals. Property distributions made in a deceased person's will can be challenged by a disgruntled beneficiary. A surviving spouse can redirect assets after they have been bequeathed. The use of a trust makes challenges or variances for the deceased's wishes much more difficult.

Type: ES

Topic: Trusts - definition & characteristics

3) Briefly compare the income tax perspective on trusts with the legal perspective.

Answer: From a legal perspective, a trust is not a separate legal entity. However, for income tax purposes, the ITA *treats a* trust as an individual. This means that a trust will have a net income and taxable income as well as federal income tax payable in a manner somewhat similar to that of an individual (e.g. human being). This also means that a trust may be required to file an annual income tax return.

Type: ES

Topic: Trusts - basic rules & general concepts

4) Legally, the estate of a deceased individual is not the same as a trust. Given this, why does the ITAuse the terms estate and trust as though they had the same meaning?

Answer: When an individual dies and bequeaths their property through a will, immediate distribution of all of this property may not be possible. During the period between an individual's death and the time that the property is distributed to beneficiaries, it is possible that some income will be earned with respect to the estate property administered by the executor. The deceased individual's income to the date of death will be included in their final income tax return. However, the income earned by the estate during the period that it is administered by the executor cannot be allocated to either the deceased person or to beneficiaries directly. To solve this problem, the ITArequires that the income of the estate be included in a trust return (T3). As the rules for filing a return for an "estate" are the same as those for a trust, the ITA treats these two terms as the same.

Type: ES

Topic: Trusts - basic rules & general concepts

5) In order for a trust to legally exist, certain conditions must be met that are referred to as the three certainties. What are these three certainties?

Answer: The three certainties are:

1. there must be an intent on the part of the settlor to create a trust;

2. the property that is the subject of the trust must be identifiable and the ownership must be transferred to the trust (the trustee(; and

3. the identity of the beneficiary or beneficiaries of the trust must be known with certainty.

Type: ES

Topic: Trusts - definition & characteristics

6) Briefly describe two non-tax reasons for using a trust.

Answer: There are several other possibilities but the main reasons are as follows:

**Administration of Property -** A trust can be used to provide for administration of property by someone other than the beneficiary.

**Protection from Creditors -** A trust can be used to protect property from the claims of creditors.

**Privacy -** Property that is in a trust when an individual dies, or placed in a testamentary trust as the result of the individual's death, are not subject to probate, a process where the details can be accessed by the public.

**Avoiding Changes in Beneficiaries -** As trusts are difficult to change, placing property in a trust ensures that they will ultimately be given to the intended beneficiaries.

Type: ES

Topic: Trusts - definition & characteristics

7) What is a "personal trust"?

Answer: As defined in the ITA, a personal trust is either a testamentary trust or, alternatively, an inter vivos trust in which no beneficial interest was acquired by paying consideration to either the trust or the settlor of the trust.

Type: ES

Topic: Trusts - definition & characteristics

8) Describe the basic model that is used for the taxation of trusts. Your answer should include the income tax effects for settlors, the trust itself, and the beneficiaries.

Answer: The basic model treats the various participants as follows:

**Settlor -** The transfer of property by the settlor to the trust is, in general, considered to be a disposition. Possible income tax consequences include capital gains, capital losses, recapture, and terminal losses. There are rollovers available for certain types of trusts such as alter ego trusts and spousal or common-law partner trusts. If a rollover is unavailable the disposition is considered to have taken place at FMV resulting in potential income tax consequences to the settlor.

**Trust -** Income that is earned by the trust is, in general, subject to federal income tax at the maximum 33%. The major exception to this general rules is a Graduated Rate Estate (GRE). GREs can use the same graduated income tax rates that apply to individuals. To the extent that this income is paid or payable to beneficiaries, it will be included in their income and not that of the GRE.

**Beneficiaries -** The beneficiaries are, in general, required to include in their personal income any trust income that is paid or payable to them in the year. Capital property distributions to beneficiaries on the other hand are generally subject to tax free rollovers avoiding income tax to both the trust and beneficiaries.

Type: ES

Topic: Trusts - basic rules & general concepts

9) What is the difference between an inter vivos trust and a testamentary trust? Explain briefly how income tax payable is determined for these two types of trusts.

Answer: The term testamentary trust refers to a trust that arises upon, and as a consequence of, the death of an individual. In contrast, an inter vivos trust refers to any personal trust other than a testamentary trust. Stated alternatively, an inter vivos (Latin for "among the living") trust is a trust created during the lifetime of the settlor.

For inter vivos trusts and most testamentary trusts, the federal income tax payable on the income of the trust that is not distributed or allocated to beneficiaries is subject to a federal income tax rate of 33%. However, estate property that has not been fully distributed or allocated to beneficiaries can be designated as a Graduated Rate Estate (GRE). Such GREs will calculate federal income tax payable using the schedule of graduated income tax rates used by individuals (15%, 20.5% etc). GRE status may continue for up to 36 months after the death of the individual whose property forms the estate.

Type: ES

Topic: Trusts - basic rules & general concepts

10) What is a qualifying spousal trust? What is the major income tax advantage associated with a trust being classified as a qualifying spousal trust? Briefly describe two non-income tax reasons for using a qualifying spousal trust.

Answer: For a trust to be classified as a qualifying spousal trust, the following conditions must be met:

• The transferor's spouse is entitled to receive all of the income of the trust arising before the spouse or common-law partner's death.

• No person other than the spouse may receive or benefit from any of the income or capital of the trust, prior to the death of the spouse or common-law partner.

The major income tax advantage of a spousal trust over other types of trusts is the fact that property can be transferred to this type of trust on a rollover basis without any immediate income tax implications to the settlor or trust.

The two significant non-income tax reasons for using a qualifying spousal trust are:

• The trust can provide for the appropriate management of the transferred property, particularly when the properties are used in an active business.

• The trust can ensure that the properties are distributed in the manner desired by the settlor. While qualification requires that the transferred property must "vest indefeasibly" with the spouse or common-law partner, the trust document can specify who the property should be distributed to after the spouse or common-law partner dies. This could ensure, for example, that the properties are ultimately distributed only to the settlor's children if the spouse or common-law partner has remarried or entered into a common-law partnership.

Type: ES

Topic: Trusts - qualifying spousal or common-law partner trusts

11) What conditions must be satisfied in order for a trust to qualify as an alter ego trust? Briefly describe the income tax and non-income tax reasons for using an alter ego trust.

Answer: The following conditions must be met in order to establish an alter ego trust:

• The settlor must be 65 years of age or over.

• The settlor is entitled to receive all of the income of the trust that arises during the settlor's lifetime.

• No person other than the settlor can receive or make use of the capital or income of the trust during the settlor's lifetime.

The major income tax advantage of these arrangements is that property can be transferred into such trusts on a rollover basis. An additional feature is the possibility of establishing the residence of the trust in a low tax rate province or territory, thereby minimizing the income taxes that will arise at the time of death.

With respect to the non-income tax advantage of such arrangements, the basic feature is that the property in the trust will not be part of the settlor's estate at the time of death. This means that these properties will not have to go through the probate process, a process that can be both costly and time consuming.

Type: ES

Topic: Trusts - alter-ego trusts

12) In order to avoid probate fees, an Ontario resident is planning to transfer all of of their capital property to a joint spousal trust. These capital properties have appreciated significantly with the result that a disposition at FMV would result in considerable capital gains. The individual is aware that a rollover is available and is also aware that the rollover option can be elected out of in favour of a disposition at FMV. Why might an individual choose dispositions at FMV?

Answer: There are two major reasons why an individual might elect out of the rollover provision that is available on transfers to a joint spousal trust. The first is that the individual may have net capital or non-capital loss balances or anticipates capital losses that could be used to offset any capital gains on the property transferred to the trust. The second is that the transferred property may include property that qualifies for the capital gains deduction. If this is the case, that deduction could be used to offset all or part of the capital gains that arises on the transfer.

Type: ES

Topic: Trusts - basic rules & general concepts

13) What are the income tax consequences associated with a transfer of trust property to a capital beneficiary?

Answer: In general, ITA 107(2) provides a rollover of trust property to a capital beneficiary. That is, the proceeds to the trust are deemed to be the trust's tax cost (i.e., ACB or UCC), and these same amounts become the tax costs of the property to the recipient capital beneficiary. The major exceptions to this rollover are as follows:

• Transfers from a qualifying spousal or qualifying common-law partner trust to anyone other than a spouse or common-law partner.

• Transfers from an alter ego trust to anyone other than the individual who settled the trust.

• Transfers from a joint spousal or joint common-law partner trust to anyone other than the settlor or the spouse or common-law partner.

In the case of these exceptions, the transfer/disposition will take place at FMV resulting in potential income or gains to the trust.

Type: ES

Topic: Trusts - capital property distributions (ITA 107(2))

14) Briefly describe the 21 year deemed disposition rule. Your answer should include the objective of this rule.

Answer: This rule requires that there be a deemed disposition and reacquisition of trust capital property every 21 years. The disposition is deemed to be at FMV, resulting in the recognition of any accrued gains on trust property. Like corporations, trusts have an unlimited life. In the absence of this rule, capital gains could accrue for an unlimited period of time inside the trust even though the trust has outlived the settlor and beneficiaries of the trust. The tax policy with respect to individuals is that a final accounting of accrued gains on the death of an individual should take place except where the property remains within a family which is generally restricted to spouses and common-law partners. This rule is designed to limit the accrual period.

Type: ES

Topic: Trusts - the 21 year rule (ITA 104(4))

15) The preferred beneficiary election allows amounts to be included in the income of a beneficiary even though the amounts is not paid or payable to that beneficiary. What is the objective of this election?

Answer: The preferred beneficiary election is only available if:

• the beneficiary is eligible to claim the disability tax credit; regardless of age or

• the beneficiary is 18 years of age or older, is claimed by another individual as a dependant because of a mental or physical impairment, and does not have income that exceeds the BPA ($14,398 for 2022).

As such individuals usually have very little income, the objective of this provision is to allow the relevant amounts to be subject to low income tax rates, while not actually transferring the funds to an individual who might not be able to use them in an appropriate manner (e.g., a mentally infirm child). The election is designed to protect the financial future of certain individuals.

Type: ES

Topic: Trusts - preferred beneficiary election

16) A trust will normally deduct all amounts that are paid or payable to a beneficiary. However, under ITA 104(13.1), a trust can designate certain amounts that have been paid or are payable as "not having been paid or payable in the year". This will result in the trust having to include these amounts in its own income. Why would a trust make such a designation?

Answer: **Use of Trust Losses -** A trust cannot allocate losses to beneficiaries. This means that the only way that an unused losses can be used is through a carry over to another year with sufficient taxable income. Many trusts however are required to distribute all income each year meaning that any trust losses would never be used. A solution to this problem is for the trust to designate sufficient income as having not been paid payable to absorb the loss carryovers. This can satisfy the legal requirement to distribute the income, while simultaneously creating sufficient income within the trust to utilize the loss which ultimately saves income tax.

Type: ES

Topic: Trusts - amounts deemed not paid (ITA 104(13.1))

17) What is the difference between a discretionary and a non-discretionary trust?

Answer: A discretionary trust is one in which the trustees are given the power to decide the amounts that will be distributed to each of the beneficiaries, usually on an annual basis. In contrast, a non-discretionary trust is one in which the amounts and timing of distributions to income and capital beneficiaries are specified in the trust agreement.

Type: ES

Topic: Trusts - basic rules & general concepts

18) Describe the income tax treatment when a trust realizes capital gains.

Answer: If the trust distributes all of the capital gain to a beneficiary, there will be no income tax consequences to the trust. The beneficiary will include one-half of the capital gain in income as a taxable capital gain.

If the trust does not distribute the gain, one-half will be included in the income of the trust as a taxable capital gain and the remaining one-half becomes part of the trust's capital. As part of the capital balance, this one-half of the gain can be distributed on a tax free basis to beneficiaries.

Type: ES

Topic: Trusts - basic rules & general concepts

19) A testamentary trust has been designated as a graduated rate estate (GRE). In accordance with the decedent's will, the surviving spouse and the adult son each receive 40% of the GRE's income and the remaining 20% of the GRE's income is retained by the GRE. Briefly describe the income tax consequences of the income earned and retained by the GRE, and the income distributed by the GRE to the surviving spouse and son.

Answer: The income paid to the surviving spouse and son will be included in their income in the year paid and will be deductible to the trust from its income.

For the first 36 months after the death, the income of the GRE will be subject to the same graduated income tax rates that apply to individuals rather than the maximum rate of 33% that generally applies to most other trusts.

There is no income attribution to deceased individuals.

Type: ES

Topic: Trusts - graduated rate estates (GRE)

20) What are the income tax consequences for the settlor if the CRA concludes that a trust is a reversionary trust?

Answer: If a trust is considered to be reversionary, any income or loss generated by property that the settlor has transferred to the trust will be attributed to that person, rather than to the intended beneficiaries. This would include capital gains or capital losses resulting from a disposition of the property.

Type: ES

Topic: Trusts - attribution to settlor (reversionary trust rule ITA 75(2))

21) What is a family trust? What is the usual objective of such trusts?

Answer: While the expression is not defined in the ITA, the term is commonly used to refer to a personal trust that has been established during one's lifetime with members of the settlor's family as beneficiaries. The usual objective of such trusts is income splitting.

Type: ES

Topic: Trusts - family trusts

22) List and describe three non-income tax considerations that are involved in estate planning.

Answer: The required three can be selected from the following that were described in the textbook:

**Intent of the Testator -** The foremost goal of estate planning is to ensure that the wishes of the testator (a person who has died and left a will) are carried out. This will involve ensuring that the properties left by the testator are distributed at the appropriate times and to the specified beneficiaries.

**Preparation of a Final Will -** The major document in the estate planning process is the final will. It should be carefully prepared to provide detailed instructions for the disposition of property, investment decisions to be made, and the extent to which trusts will be used.

**Preparation of a Living Will -** Equally important to the preparation of a final will, a living will provides detailed instructions regarding investments and other personal decisions in the event of physical or mental incapacity at any point in a person's lifetime.

**Ensuring Liquidity -** A plan should be established to provide for liquidity at the time of death.

**Simplicity -** While the disposition of a large estate will rarely be simple, effective estate planning should ensure that the plan can be understood by the testator and all beneficiaries of legal age.

**Avoidance of Family Disputes -** If equitable treatment of beneficiaries is a goal of the testator, efforts should be made to ensure that all beneficiaries believe that they have been treated in an equitable manner.

**Expediting The Transition -** The procedures required in the settlement of an estate should be designed to expedite the process.

Type: ES

Topic: Trusts - estate planning

23) An estate freeze can be carried out by simply gifting property directly to the intended beneficiaries. What are the disadvantages of this approach?

Answer: The two major disadvantages are as follows:

• The gifting provisions of ITA 69(1) require that gifts be treated as a disposition at FMV resulting in immediate income tax consequences to the settlor.

• If the property relates to an ongoing business, the individual making the gift will lose control of the property.

Type: ES

Topic: Trusts - estate freeze

24) The beneficiaries of a trust have legal title to trust property.

Answer: FALSE

Explanation: The trustee(s) possess legal title to trust property. Beneficiaries only have a beneficial interest.

Type: TF

Topic: Trusts - definition & characteristics

25) If a period of time passes between the time of an individual's death and the distribution of the individual's properties, income may be earned with respect to these properties. If this is the case, the administrator of the individual's estate will have to file a T3 trust income tax return.

Answer: TRUE

Type: TF

Topic: Trusts - basic rules & general concepts

26) To establish a trust, a lawyer must prepare, in writing, a formal trust agreement.

Answer: FALSE

Explanation: While it is generally advisable to have a trust agreement in writing, verbal agreements can be used to establish a trust.

Type: TF

Topic: Trusts - definition & characteristics

27) A trust can be used to protect some of an individual's properties from the claims of creditors.

Answer: TRUE

Type: TF

Topic: Trusts - definition & characteristics

28) A spousal or common-law partner trust can either be an inter vivos trust or a testamentary trust.

Answer: TRUE

Type: TF

Topic: Trusts - basic rules & general concepts

29) As long as he or she is the only beneficiary, any individual can transfer property to an Alter Ego trust.

Answer: FALSE

Explanation: Only individuals who are 65 or older can establish an Alter Ego trust.

Type: TF

Topic: Trusts - alter-ego trusts

30) Any transfer of property by a settlor to a trust will be treated as a disposition at FMV.

Answer: FALSE

Explanation: There are several rollovers that can be used to transfer property at tax costs (e.g., transfers to a spousal trust).

Type: TF

Topic: Trusts - basic rules & general concepts

31) While there are exceptions, transfers of trust property to beneficiaries can generally be made without income tax consequences to either the trust or the beneficiary.

Answer: TRUE

Explanation: Such transfers are usually made at the trust's tax cost. An exception would be a transfer of property from an Alter Ego trust to someone other than the settlor.

Type: TF

Topic: Trusts - capital property distributions (ITA 107(2))

32) An inter vivos trust can designate amounts to be deemed not paid or payable when they are, in fact, paid or payable to beneficiaries. One reason for doing this would be to have the income taxed at a lower income tax rate in the trust.

Answer: FALSE

Explanation: All of the income of an inter vivos trust is taxed at the maximum federal rate of 33%.

Type: TF

Topic: Trusts - amounts deemed not paid (ITA 104(13.1))

33) If a trust receives eligible dividends and does not distribute them or allocate them to a beneficiary, the trust will be eligible for the usual dividend tax credit on such dividends.

Answer: TRUE

Type: TF

Topic: Trusts - basic rules & general concepts

34) The three essential characteristics of a trust are certainty of:

• the identity of the property to be contributed to the trust;

• an intent on the part of the settlor to create a trust; and

• the basis for allocating the trust income to the beneficiaries.

Answer: FALSE

Explanation: While the identity of the beneficiaries is an essential characteristic, their respective income allocations are not.

Type: TF

Topic: Trusts - definition & characteristics

35) Income that is flowed through a trust generally retains its tax characteristics (e.g., a dividend earned by the trust can be allocated to a beneficiary as a dividend).

Answer: TRUE

Explanation: While there are exceptions this is the general rule.

Type: TF

Topic: Trusts - basic rules & general concepts

36) The federal income tax payable of an inter vivos trust will be calculated using the same schedule of graduated income tax rates that apply to individuals.

Answer: FALSE

Explanation: Inter vivos trusts are subject to a federal income tax rate of 33%.

Type: TF

Topic: Trusts - basic rules & general concepts

37) If non-depreciable capital property is transferred to a qualifying spousal trust, there will be no capital gain or capital loss on the transfer, any income earned on the property will be attributed back to the settlor, but capital gains or capital losses on a subsequent disposition of the property by the trust will not be attributed back to the settlor.

Answer: FALSE

Explanation: Income, loss, capital gains and capital losses will be attributed back to the spouse who is the settlor.

Type: TF

Topic: Trusts - qualifying spousal or common-law partner trusts

38) Which of the following statements with respect to inter vivos trusts is **NOT** correct?

A) These trusts must use the calendar year as their taxation year.

B) Any trust income not allocated to beneficiaries will be subject to the maximum federal income tax rate of 33%.

C) If all of the trust's income is paid or payable to beneficiaries, the trust will not have any income tax payable.

D) Trust income is not subject to the income attribution rules.

Answer: D

Explanation: D) Trust income is not subject to the income attribution rules.

Type: MC

Topic: Trusts - basic rules & general concepts

39) Which of the following is **NOT** required for the successful establishment of a trust?

A) The settlor must clearly intend to create a trust.

B) The individual beneficiaries must be named.

C) The property to be held in the trust must be known with certainty.

D) There must be an actual transfer of property ownership to the trust.

Answer: B

Explanation: B) The individual beneficiaries must be named. Naming individual beneficiaries is not necessary as long as the beneficiaries are members of an identifiable group (e.g., the settlor's children).

Type: MC

Topic: Trusts - definition & characteristics

40) With respect to the role of a trustee, which of the following statements is correct?

A) The trustee can also be the settlor of the trust, but not one of the beneficiaries.

B) The trustee will have legal title to the trust property.

C) All of the benefits of the trust will accrue to the trustee.

D) The trustee cannot enter into contracts on behalf of the trust.

Answer: B

Explanation: B) The trustee will hold formal legal title to the trust property.

Type: MC

Topic: Trusts - definition & characteristics

41) A graduated rate estate (GRE) is a testamentary trust that has been designated as such in its first income tax return. Which of the following statements is correct with respect to GREs?

A) Its taxation year must be the calendar year.

B) The income tax return is due 90 days after the trust's taxation year end.

C) All of the trust income will be subject to the highest federal income tax rate of 33%.

D) The trust will not be eligible for a dividend tax credit on taxable dividends included in the income of the trust that are not allocated to beneficiaries.

Answer: B

Explanation: B) The trust income tax return is due 90 days after the trust's taxation year end.

Type: MC

Topic: Trusts - graduated rate estates (GRE)

42) Which of the following types of trusts allows for a rollover for property contributed to the trust?

1. Inter Vivos spousal trusts.

2. Testamentary spousal trusts.

3. Family Trusts

4. Alter ego trusts.

A) 1, 2 and 4.

B) 2 and 4.

C) 1 and 2.

D) 1, 2, 3, and 4.

Answer: A

Explanation: A) 1, 2 and 4

Type: MC

Topic: Trusts - types & classification of trusts

43) Which of the following statements is **NOT** correct?

A) A trust can be used to administer property for beneficiaries with limited property management experience.

B) A trust can be used to ensure that properties are ultimately distributed to the intended beneficiaries.

C) A trust can be used to avoid the income attribution rules that would apply to a spouse or common-law partner.

D) A trust can be used to protect property from creditors.

Answer: C

Explanation: C) A trust can be used to avoid the income attribution rules that would apply to a spouse or common-law partner. In general, it is not possible to avoid the income attribution rules by transferring property to a trust in favour of a spouse or common-law partner.

Type: MC

Topic: Trusts - definition & characteristics

44) Which of the following trusts could be either a testamentary or an inter-vivos trust?

A) An alter ego trust created by an individual who is 65 years of age.

B) A spousal trust created to benefit a spouse.

C) A family trust established by a parent while alive to benefit their children.

D) A joint spousal trust created for the benefit of an individual and their spouse.

Answer: B

Explanation: B) A spousal trust created to benefit a spouse.

Type: MC

Topic: Trusts - types & classification of trusts

45) When an individual dies, there is a deemed disposition of certain types of property. This would include property held by one type of trust for which the deceased individual was a settlor. That type of trust is:

A) a discretionary trust.

B) a testamentary trust.

C) a joint spousal or common-law partner trust.

D) an alter ego trust.

Answer: D

Explanation: D) An alter ego trust.

Type: MC

Topic: Trusts - types & classification of trusts

46) Which one of the following statements with respect to a qualifying spousal trust is **NOT** correct?

A) The transferor's spouse must be entitled to receive all of the income of the trust arising before the spouse's death.

B) The settlor must be 65 years of age or older.

C) No person other than the spouse may receive or benefit from any of the income or capital of the trust, prior to the death of the spouse.

D) A spousal trust can be a non-discretionary trust.

Answer: B

Explanation: B) The settlor must be 65 years of age or older. There is no age requirement for the settlor.

Type: MC

Topic: Trusts - qualifying spousal or common-law partner trusts

47) Which one of the following statements with respect to an alter ego trust is correct?

A) An alter ego trust can be either an inter vivos trust or a testamentary trust.

B) For the settlor, the POD for property transferred to the trust will be equal to the FMV of the properties at the time of transfer.

C) Any resident individual can settle an alter ego trust.

D) When properties are transferred out of an alter ego trust to anyone other than the settlor, the POD to the trust will be the FMV of the properties transferred.

Answer: D

Explanation: D) When properties are transferred out of an alter ego trust to anyone other than the settlor, the POD to the trust will be the FMV of the properties transferred.

Type: MC

Topic: Trusts - alter-ego trusts

48) On July 1, 2022, Martin Long transfers shares with a FMV of $300,000 to a newly established inter vivos trust. His 35 year old son, Shorty Long, is the only beneficiary. Martin's ACB for these shares was $170,000. In 2022, the trust receives eligible dividends on the shares of $21,000. All of these dividends are distributed to Shorty.

What are the income tax consequences of these transactions to Martin, the trust and Shorty?

A) The trust will include dividend income of $21,000 and will claim the dividend tax credit. There will be no income tax consequences for Martin or Shorty.

B) The trust will have no income. Shorty will include dividend income of $21,000 which must be grossed up and will claim the dividend tax credit. There will be no income tax consequences for Martin.

C) Martin will include a taxable capital gain of $65,000 [(1/2)($300,000 - $170,000)] in his 2022 net income. The trust will have no income. Shorty will include dividends received of $21,000 which must be grossed up and will claim the dividend tax credit.

D) Martin will include a taxable capital gain of $65,000 [(1/2)($300,000 - $170,000)] in his 2022 net income. The trust will include dividend income of $21,000 which must be grossed up and will claim the dividend tax credit. There will be no income tax consequences for Shorty.

Answer: C

Explanation: C) Martin will include a taxable capital gain of $65,000 [(1/2)($300,000 - $170,000)] in his 2022 net income. The trust will have no income. Shorty will include dividends received of $21,000 which must be grossed up and will claim the dividend tax credit.

Type: MC

Topic: Trusts - taxation of trusts

49) Anika is planning to create a testamentary trust. She has not yet decided if the beneficiaries will be only her common-law partner Belinda, only their 14 year old blind daughter Elena, or both Belinda and Elena equally. The non-depreciable capital property she will transfer to the trust has an ACB of $45,000 and a FMV of $75,000. In order to defer the taxation of the capital gain on the transferred property until it is sold by the beneficiary(ies), which alternative should Anika use?

A) Anika should transfer the property to a trust to benefit only their daughter, Elena.

B) Anika should transfer the property to a common-law partner trust.

C) Anika should transfer the property to a trust with both Elena and Belinda as beneficiaries.

D) Anika cannot defer the taxation of the capital gain with the use of a trust.

Answer: B

Explanation: B) Anika should transfer the property to a common-law partner trust.

Type: MC

Topic: Trusts - types & classification of trusts

50) In 2021, Diego transferred non-depreciable capital property with an ACB of $400,000 and a FMV of $750,000 to an alter ego trust. In his will, Diego bequeaths all his property to his son. At his death in 2022, when the trust transfers the property to his son, the FMV of the property has increased to $800,000. Diego uses any rollovers that are available to minimize the income tax consequences. What are the income tax consequences of the two transfers?

A) In 2021, a rollover would allow Diego to transfer his property to the trust without any income tax consequences. In 2022, when the trust transfers the property to his son, the trust will include a taxable capital gain of $200,000 [(1/2)($800,000 - $400,000)] in income.

B) In 2021, there will be no rollover available, and Diego will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2022, when the trust transfers the property to his son, there will be a rollover available, and the trust will not report any income or capital gains.

C) There will be no rollover available for either transaction. In 2021, Diego will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2022, when the property is transferred to his son, the trust will include a taxable capital gain in income of $25,000 [(1/2)($800,000 - $750,000)].

D) Rollovers will be available to defer income tax on both transactions.

Answer: A

Explanation: A) In 2021, a rollover would allow Diego to transfer his property to the trust without any income tax consequences. In 2022, when the trust transfers the property to his son, the trust will include a taxable capital gain of $200,000 [(1/2)($800,000 - $400,000)] in income.

Type: MC

Topic: Trusts - alter-ego trusts

51) In 2021, Emilio, who is 82 years old, transfers property with an ACB of $400,000 and a FMV of $750,000 to an inter vivos family trust to benefit his 3 adult children. In 2022, he becomes seriously disappointed with his two sons, and decides to have the trust transfer the trust property to his daughter. Subsequent to the distribution, the trust is terminated. At the time of the trust's distribution to the daughter, the FMV of the property has increased to $800,000. For both transactions, Emilio uses any rollovers that are available to minimize any income tax consequences. What are the income tax consequences of the two transfers?

A) In 2021, a rollover would allow Emilio to transfer his property to the trust tax free. In 2022, when the trust transfers the property to his daughter, the trust will include a taxable capital gain of $200,000 [(1/2)($800,000 - $400,000)] in income.

B) In 2021, there will be no rollover available, and Emilio will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2022, when the trust transfers the property to his daughter, there will be a rollover available, and the trust will not report any income.

C) There will not be a rollover available for either transaction. In 2021, Emilio will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2022, when the property is transferred to his daughter, the trust will include a taxable capital gain in income of $25,000 [(1/2)($800,000 - $750,000)].

D) Rollovers will be available to defer income tax on both transactions.

Answer: B

Explanation: B) In 2021, there will be no rollover available, and Emilio will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2022, when the trust transfers the property to his daughter, there will be a rollover available, and the trust will not report any income.

Type: MC

Topic: Trusts - family trusts

52) Which of the following amounts can be allocated to beneficiaries of a trust?

A) Losses incurred on the disposition of trust capital property.

B) Capital gains resulting from the disposition of trust capital property.

C) Recapture of CCA on the disposition of trust depreciable property.

D) Items A, B, and C.

E) Items B and C.

Answer: E

Explanation: E) Items B and C.

Type: MC

Topic: Trusts - the taxation of trusts

53) Which of the following amounts will **NOT** affect the net income of a trust?

A) Income as a result of a preferred beneficiary election.

B) Amounts paid or payable to a beneficiary of the trust.

C) The difference between the FMV and the tax cost of property transferred to a resident capital beneficiary.

D) Income retained for beneficiary under 21 years of age.

Answer: C

Explanation: C) The difference between the FMV and the tax cost of property transferred to a resident capital beneficiary. While there are some exceptions to this, such transfers occur on a rollover basis and therefore do not effect the net income of a trust or beneficiary.

Type: MC

Topic: Trusts - net income & taxable income

54) Upon his death three years ago, Mr. Allen's will provided for the creation of a trust. The will required that any income distributed by the trust be allocated 50% to his spouse, and 12.5% to each of his four children. In 2022, the trust had the following income and expense:

Eligible Dividends $20,000

Interest Income Canadian Sources 10,000

Interest Expense on money borrowed to purchase shares 1,000

In 2022, the beneficiaries and the trustees jointly agreed that all income received by the trust, except for $5,000 of the interest income, would be paid to the beneficiaries. What is the taxable income attributable to Mrs. Allen for the year from the trust?

A) $12,000.

B) $12,500.

C) $15,800.

D) $15,000.

E) $13,800.

Answer: C

Explanation: C) $15,800. This would be calculated as follows:

Dividends Received $20,000

Gross-Up on Dividends [($20,000)(38%)] 7,600

Interest Income ($10,000 - $5,000) 5,000

Interest Expense ( 1,000)

Net Income & Taxable Income - Trust $31,600

Mrs. Allen's Percentage 50%

Taxable Income - Mrs. Allen $15,800

Type: MC

Topic: Trusts - net income & taxable income

55) Upon his death three years ago, Mr. Tajima's will provided for the creation of a trust with his four children as beneficiaries. In 2022, the trust's income consisted of interest received from Canadian sources of $20,000. In 2022, the trustees jointly agreed that all income received by the trust, except for the following two amounts would be paid to the beneficiaries.

Interest income retained by the trust $8,000

Share of interest allocated to a 5 year old beneficiary

that will be paid when he turns 18 $3,000

In addition, the trust designated the income share of one beneficiary not to be paid, even though the beneficiary received the payment. The amount was $5,000. What is the 2022 net income of the trust?

A) $11,000.

B) $13,000.

C) $16,000.

D) $20,000.

Answer: B

Explanation: A) $11,000. [$8,000 + $3,000]

B) $13,000. [$8,000 + $5,000]

C) $16,000 [$8,000 + $3,000 + $5,000]

D) $20,000

Type: MC

Topic: Trusts - net income & taxable income

56) Which of the following statements is correct with respect to the preferred beneficiary election?

A) This election is available for beneficiaries that are eligible for the disability tax credit, or who are eligible to be claimed by another individual for either the infirm dependant over 17 credit or the caregiver credit.

B) A trust cannot deduct amounts that are paid or payable to a preferred beneficiary.

C) A trust can deduct amounts allocated to, but not distributed to, a preferred beneficiary.

D) The preferred beneficiary election is used when the trust wants to allocate 100% of its income to a particular beneficiary for one year.

Answer: C

Explanation: C) A trust can deduct amounts allocated to, but not distributed to, a preferred beneficiary.

Type: MC

Topic: Trusts - preferred beneficiary election

57) An inter vivos trust received $50,000 in eligible dividends. In addition, it received interest income of $12,000 in the current year. The trust incurred accounting fees of $2,000 which were deducted by the trust. The trust has one beneficiary who is 23 years old and has no other income or capital gains. During the current year, all of the dividends were distributed to the beneficiary and none of the interest. What is the net income of the beneficiary?

A) $69,000.

B) $67,000.

C) $81,000.

D) $50,000.

Answer: A

Explanation: A) $69,000 [(138%)($50,000)]

B) $67,000 = $69,000 - $2,000 fee

C) $81,000 = [(138%)($50,000) + $12,000]

D) $50,000 ( no GU)

Type: MC

Topic: Trusts - income allocations to beneficiaries

58) The Weir family trust is an inter vivos trust with one beneficiary. The beneficiary is 25 year old Marcus Weir, the son of the settlor. In 2022, the trust had the following income:

Eligible dividends from

publicly traded Canadian corporations $ 50,000

Non-eligible dividends from a family owned CCPC 200,000

Capital gain from a sale of shares 30,000

The non-eligible dividends and capital gain are distributed to Marcus. By how much will Marcus' 2022 net income increase as a result of this distribution?

Ignore the possibility that the income received by Marcus could be subject to the TOSI.

A) $245,000.

B) $291,000.

C) $215,000.

D) $265,000.

Answer: A

Explanation: A) $245,000. This would be calculated as follows:

Non-eligible dividends received $200,000

Gross-up on non-eligible dividends [($200,000)(15%)] 30,000

Taxable capital gain [(1/2)($30,000)] 15,000

Income Increase $245,000

B) $291,000 [(138%)($200,000) + $15,000]

C) $215,000 (No gross up)

D) $265,000 ($200,000 + $50,000 + $15,000 TCG)

Type: MC

Topic: Trusts - income allocations to beneficiaries

59) The Strike family trust is an inter vivos trust with one beneficiary, Maria Strike, the 25 year old daughter of the settlor, Gregor Strike. The trust receives interest income of $150,000 in 2022. The trust makes a charitable donation of $15,000 and distributes $105,000 to Maria. Maria has no income other than what she receives from the trust, and is eligible only for the BPA. Determine the trust's 2022 federal income tax payable. Ignore the possibility that the income received by Maria could be subject to the TOSI.

A) $14,850.

B) $9,900.

C) $1,836.

D) $9,936.

Answer: D

Explanation: A) [(33%)($150,000 - $105,000)] = $14,850

B) [(33%)($150,000 - $15,000 - $105,000)] = $9,900

C) [(15%)($150,000 - $105,000) ) - $4,914] = $1,836

D) Charitable donation tax credit = [(15%)($200) + (33%)($14,800)] = $4,914

Trust TP = [(33%)($150,000 - $105,000) - $4,914 = $9,936

Type: MC

Topic: Trusts - income tax payable of personal trusts

60) On the death of Martin Meryk, the shares in Meryk Limited, a CCPC, became part of his estate which was designated as a graduated rate estate (GRE). In 2022, the GRE receives non-eligible dividend income from Meryk Limited in the amount of $200,000. Martin's will requires that one-half of the dividends be distributed to his spouse, Marta. Marta has no income other than what she receives from the trust. Which of the following statements is correct?

A) The federal income tax payable is the same for Marta and the GRE.

B) The net income for Marta and the GRE are the same.

C) The federal dividend tax credit is available to Marta, but not to the GRE.

D) The income retained in the GRE is taxed at a federal income tax rate of 33%.

Answer: B

Explanation: B) The net income for Marta and the GRE are the same.

Type: MC

Topic: Trusts - net income & taxable income

61) Saddam Holt transfers capital properties to a trust in favour of his spouse, Lena Holt. She is the only income and capital beneficiary of the trust. Which of the following statements with respect to this trust is **NOT** correct?

A) Trust income that is not paid or payable to a beneficiary will be subject to the maximum federal income tax rate of 33%.

B) Any property income that is not paid or payable to a beneficiary will be attributed back to Mr. Holt.

C) Any capital gains of the trust will not be attributed to Mr. Holt.

D) Any income that is paid or payable to Mrs. Holt will be attributed to Mr. Holt.

Answer: C

Explanation: C) Any capital gains of the trust will not be attributed to Mr. Holt. Only capital gains designated to Mrs. Holt by the trust will be subject to attribution.

Type: MC

Topic: Trusts - attribution of income & capital gains

62) On January 1 of the current year, Mandeep Gill contributed investments with an ACB of $95,000 and a FMV of $250,000 to a family trust for no consideration. One-half of the income of the trust is allocated to his 12 year old son, and the other half to his spouse. The trust earns $7,000 in interest income during the year. What will the income tax consequences of these transactions be to Mandeep?

A) Mandeep will have a taxable capital gain of $77,500 and will have attributed interest income of $7,000.

B) Mandeep will not have a taxable capital gain on the contribution, but the interest income of $7,000 will be attributed to him.

C) Mandeep will have a taxable capital gain of $77,500. No interest income will be attributed to him.

D) Mandeep will have a taxable capital gain of $77,500 and the interest income allocated to Mrs. Gill of $3,500 will be attributed to him.

Answer: A

Explanation: A) Mandeep will have a taxable capital gain of $77,500 and will have attributed interest income of $7,000.

Type: MC

Topic: Trusts - attribution of income & capital gains

63) The Burton family trust was created when Mr. Burton transferred publicly traded shares with an ACB of $300,000 and a FMV of $750,000 to the trust. The beneficiaries are Mr. Burton's two sons, Tim and Jerry Burton, both of whom are over 30 years old. They have equal shares in the income and capital of the trust.

At a later point in time, when the value of the shares has increased to $2,100,000, Tim purchases Jerry's capital interest in the trust for $1,050,000 [(1/2)($2,100,000)]. The income tax consequences of this transaction to Tim and Jerry are as follows:

A) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $525,000 in his income.

B) Tim has acquired a capital interest in the trust with an ACB of nil. Jerry will include a taxable capital gain of $525,000 in his income.

C) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $150,000 in his income.

D) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $337,500 in his income.

Answer: D

Explanation: A) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $525,000 in his income. [(1/2)($1,050,000 - $0) Incorrectly uses ACB = $0]

B) Tim has acquired a capital interest in the trust with an ACB of nil. Jerry will include a taxable capital gain of $525,000. [(1/2)($1,050,000 - $0) in his income. Incorrectly uses ACB = $0 for both].

C) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $150,000 in his income. [(1/2)($1,050,000 - $750,000) Incorrectly uses ACB = $750,000].

D) Tim has acquired a capital interest in the trust with an ACB of $1,050,000. Jerry will include a taxable capital gain of $337,500 in income {[1/2][$1,050,000 - (50%)($750,000)]}.

Type: MC

Topic: Trusts - purchase or sale of an interest in a trust

64) The Ali family trust was established when Mrs. Ali transferred publicly traded shares with an ACB of $100,000 and a FMV of $250,000 to the trust. The beneficiaries are Mrs. Ali's 30 year old twin daughters, Aida and Fatima. They benefit equally from the income and the capital of the trust. In the current year, Aida purchased Fatima's capital interest from her for its FMV of $350,000 [(1/2)($700,000)]. The income tax consequences of this transaction to Aida and Fatima are:

A) Aida has acquired a capital interest in the trust with an ACB of $350,000. Fatima will include a taxable capital gain of $112,500 in her income.

B) Aida has acquired a capital interest in the trust with an ACB of $350,000. Fatima will include a taxable capital gain of $175,000 in her income.

C) Aida has acquired a capital interest in the trust with an ACB of nil. Fatima will include a taxable capital gain of $175,000 in her income.

D) Aida has acquired a capital interest in the trust with an ACB of $350,000. Fatima will include a taxable capital gain of $50,000 in her income.

Answer: A

Explanation: A) Aida has acquired a capital interest in the trust, and her ACB will be $350,000. Fatima will include a taxable capital gain of $112,500 in her income. {[1/2][$350,000 — (50%)($250,000)]}

B) Aida has acquired a capital interest in the trust with an ACB of $350,000. Fatima will include a taxable capital gain of $175,000 in her income. [(1/2)($350,000 - $0) Incorrectly uses ACB = $0]

C) Aida has acquired a capital interest in the trust with an ACB of nil. Fatima will include a taxable capital gain of $175,000 in her income. [(1/2)($350,000 - $0) Incorrectly uses ACB = $0]

D) Aida has acquired a capital interest in the trust with an ACB of $350,000. Fatima will include a taxable capital gain of $50,000 in her income. [(1/2)($350,000 - $250,000) Incorrectly uses ACB = $250,000]

Type: MC

Topic: Trusts - purchase or sale of an interest in a trust

65) Monique Flaharty has accumulated investment that earn annual interest of $45,000. Her other income exceed $250,000 per year. Her 35 year old daughter Deborah has no income of her own. Her only tax credit is the BPA. Determine the amount of federal income tax that could be saved by transferring the interest earning investments to a trust with Deborah as the income beneficiary. The trust will be required to distribute all of its income each year.

A) $8,100.

B) $10,260.

C) $4,590.

D) $12,690.

Answer: B

Explanation: A) $ 8,100 [(33%)($45,000) — (15%)($45,000)]

B) $10,260 [(33%)($45,000) — (15%)($45,000 - $14,398)]

C) $ 4,590 [(15%)($45,000 - $14,398)]

D) $12,690 [(33%)($45,000) — (15%)($14,398)]

Type: MC

Topic: Trusts - income tax planning

66) Ferran Ginton has operated a very successful bakery for 30 years, and has accumulated investment that earn annual interest income of $40,000. His other income places him in the top income tax bracket for personal income tax purposes. He has a son, Habib who is 22 years old and currently has no income. Habib's only personal tax credit is the BPA. Determine the amount of federal income tax that could be saved by transferring the interest earning investments to a trust with Habib as the income beneficiary, assuming that the trust will be required to distribute all of its income each year.

A) $7,200.

B) $9,360.

C) $3,840.

D) $11,040.

Answer: B

Explanation: A) $7,200 [(33%)($40,000) — (15%)($40,000)]

B) $9,360 [(33%)($40,000) — (15%)($40,000 - $14,398)]

C) $ 3,840 [(15%)($40,000 - $14,398)]

D) $11,040 [(33%)($40,000) — (15%)($14,398)]

Type: MC

Topic: Trusts - income tax planning

67) Which of the following is **NOT** a valid reason for using an alter ego trust?

A) An alter ego trust removes property from the estate of the settlor, and this property will not be subject to probate on the death of the settlor.

B) The trust could be established in a low income tax rate province resulting in a income tax savings on the death or emigration of the settlor.

C) The trust will be subject to lower income tax rates, and can be used to split income with the settlor.

D) If all property has been transferred to an alter ego trust prior to the death of the settlor, the settlor does not need to leave a will, which could be easily challenged. It is not as easy to challenge the validity of a trust.

Answer: C

Explanation: C) The trust will be subject to lower income tax rates, and can be used to split income with the settlor.

Type: MC

Topic: Trusts - alter-ego trusts

68) An estate freeze can be accomplished using various means. With respect to the various alternatives, which of the following statements is correct?

A) Implementing an estate freeze through the use of gifts does not involve any immediate income tax consequences.

B) The use of the rollover of ITA 85(1) to implement the estate freeze can avoid immediate income tax consequences.

C) Implementing an estate freeze with the use of an inter vivos trust can avoid immediate income tax consequences.

D) An advantage of using gifts to implement an estate freeze is that the freezor can retain control of the property.

Answer: B

Explanation: B) The use of the rollover of ITA 85(1) to implement the estate freeze can avoid immediate income tax consequences.

Type: MC

Topic: Trusts - estate freeze

69) What is the objective of an estate freeze?

A) To freeze certain family members out of participation in a large estate.

B) To allow future appreciation in property to appreciate for the benefit of specific related persons.

C) To delay the transfer of income generating private company shares to minor children to avoid the tax on split income (TOSI).

D) To allow a wealthy taxpayer to transfer valuable property to the next generation without income tax consequences.

Answer: B

Explanation: B) To allow future appreciation in property to appreciate for the benefit of specific related persons.

Type: MC

Topic: Trusts - estate freeze

70) An estate freeze can be accomplished by various techniques. Which of the following techniques will **NOT** involve immediate income tax consequences at the time of the freeze?

A) A gift to an individual's children of capital property with accrued gains.

B) A transfer of capital property with accrued gains to a corporation using ITA 85.

C) A transfer of capital property with accrued gains to a trust with the transferor's children as beneficiaries.

D) A transfer of capital property with accrued gains to a holding company in which the individual's children are the majority shareholders.

Answer: B

Explanation: B) A transfer of capital property with accrued gains to a corporation using ITA 85.

Type: MC

Topic: Trusts - estate freeze

71) In each of the following Cases, an individual is attempting to establish a trust. For each of these Cases, indicate whether the attempt has been successful. Explain your conclusion.

**Case A -** Martin Falk has signed an agreement that specifies the property that he will transfer to a trustee at the end of the current year. The income from the trust will be distributed to his friend of several years, Lola Lamour.

**Case B -** Martha Stuart transfers property to a trustee, specifying that the income from the property should be distributed to prison inmates in Ontario.

**Case C -** Joan Morgan sends a cheque to her son, indicating that the money should be used for the education of her grandchildren.

Answer:

**Case A -** While Martin has signed the agreement, it does not appear that the property has been transferred. This means that no trust has been created.

**Case B -** "Prison inmates in Ontario" cannot be considered to be an identifiable class. As a consequence, there is no certainty as to beneficiaries and no trust would be created by her transfer.

**Case C -** While Ms. Morgan has transferred property, it is not clear that her intention was to create a trust. No trust would be created by this transfer.

Type: ES

Topic: Trusts - definition & characteristics

72) On January 1, 2022, Jerry Fallen transfers publicly traded bonds with a FMV of $570,000 to a newly established inter vivos trust for which his 22 year old son, James, is the only beneficiary. The ACB of the bonds to Jerry was $520,000. In 2022, the bonds earn interest income of $32,000, all of which is distributed to James.

On January 1, 2023, the bonds are distributed to James in satisfaction of his capital interest in the trust. At this time, the FMV of the bonds has increased to $615,000. James sells all of the bonds for $615,000 on January 3, 2023. Indicate the income tax consequences for Jerry, James, and the trust, in each of 2022 and 2023.

Answer: With respect to Jerry's transfer of bonds to the trust, the transaction would be deemed to take place at FMV. This would result in a taxable capital gain to Jerry of $25,000 [(1/2)($570,000 - $520,000)]. There would be no income tax consequences to James or the trust as a result of the transfer.

As the trust distributed all of its income during the year, none of the interest would be included in the income of the trust. All of the interest would be included in James' income and, because he is an adult, there would be no income attribution to Jerry.

Under ITA 107(2), the transfer from the trust to James on January 1, 2023 would take place at the trust's tax cost of $570,000. There would be no income tax consequences for Jerry, James, or the trust as a result of this transfer. However, as James' ACB is $570,000, the sale at FMV of $615,000 would result in a taxable capital gain to him of $22,500 [(1/2)($615,000 - $570,000)].

Type: ES

Topic: Trusts - the taxation of trusts

73) At the beginning of 2022, Martha Stuart transfers investments to a trust that has her 15 year old daughter Jane as the only beneficiary. The investments have an ACB of $350,000 and a FMV of $500,000. In 2022, the investments pay eligible dividends of $50,000, all of which are distributed to Jane.

At the beginning of 2023, all of the investments are transferred to Jane in satisfaction of her capital interest. At this time their FMV is $550,000. Jane immediately sells the investments for this amount.

Indicate the income tax consequences for Martha, Jane, and the trust, for 2022 and 2023.

Answer: When Martha transfers the investments to the trust in 2022, she will recognize a taxable capital gain of $75,000 [(1/2)($500,000 - $350,000)].

With respect to the eligible dividends, as Jane is under 18 years of age, they will be attributed back to Martha. This will result in an income inclusion of $69,000 [($50,000)(138%)] and will provide Martha with a federal dividend tax credit of $10,364 [(6/11)(38%)($50,000)].

The investments will be transferred to Jane at an ACB of $500,000. This means that, when she sells them, she will include a taxable capital gain of $25,000 [(1/2)($550,000 - $500,000)] in her income. Note that there is no income attribution of capital gains.

Type: ES

Topic: Trusts - the taxation of trusts

74) Larry died in 2022 and bequeathed a portfolio of investments to a qualifying common-law partner trust created in his will. Larry is survived by his common-law partner, David who is to receive the investments from the trust three years after Larry's death if they have not been sold. The portfolio, which had an ACB of $420,000, was valued at $723,000 on the date of his death.

Determine the income tax consequences of the transfer, including the ACB of the investments in the trust to David if it is transferred.

Answer: As there is a rollover available on transfers to a qualifying common-law partner trust, the accrued $303,000 gain ($723,000 - $420,000) will not be recognized until his common-law partner or the common-law partner trust eventually disposes of the investment portfolio. The common-law partner trust acquires the portfolio at an ACB of $420,000, which will be David's ACB if the trust distributed the investment portfolio to him.

Type: ES

Topic: Trusts - the taxation of trusts

75) Lara Jensen was living with her common-law partner Portia at the time of her death in 2022. Lara's will established that investments were to be transferred to a qualifying common-law partner trust. The investments had an ACB of $675,000 and a FMV of $850,000 at the time of transfer. The investments are to be transferred to Portia five years from the date of Lara's death.

What are the income tax consequences to Lara of the transfer made at the time of her death? What would be the income tax consequences to Portia if, after she receives the investments from the trust, she sells them for $950,000?

Answer: As a rollover is available on transfers to a qualifying common-law partner trust, there would be no income tax consequences for Lara at the time of the transfer to the trust. However, the ACB of the investments in the trust would be $675,000, Lara's ACB.

The investments would be distributed from the trust to Portia at the same $675,000 amount. This means that when she sells the investments for $950,000, she will have a taxable capital gain of $137,500 [(1/2)($950,000 - $675,000)].

Type: ES

Topic: Trusts - the taxation of trusts

76) An individual has non-depreciable capital property with a cost of $2,100 and a FMV of $2,500. Seven Scenarios are presented for the transfer of this property by the settlor to a trust. For each Scenario, indicate the income tax consequences to the settlor at the time of transfer, as well as the ACB of the property to the trust.

Scenario 1: Transfer to an inter vivos trust with an adult child beneficiary.

Scenario 2: Transfer to a testamentary qualifying spousal trust.

Scenario 3: Transfer to a joint common-law partner trust.

Scenario 4: Transfer to an inter vivos qualifying spousal trust.

Scenario 5: Transfer to an inter vivos trust for a beneficiary that is a minor child.

Scenario 6: Transfer to a testamentary trust for a beneficiary that was a friend.

Scenario 7: Transfer to an alter ego trust.

Answer: In those cases where a taxable capital gain will be recognized at transfer, the amount of the taxable capital gain will be $200 [(1/2)($2,500 - $2,100)].

**Taxable Capital**

**Scenario Gain (Settlor) ACB (Trust)**

1. Inter vivos trust for adult child $200 $2,500

2. Testamentary spousal trust Nil 2,100

3. Joint common-law partner trust Nil 2,100

4. Inter vivos qualifying spousal trust Nil 2,100

5. Inter vivos trust for minor child 200 2,500

6. Testamentary trust for friend 200 2,500

7. Alter ego trust Nil 2,100

Type: ES

Topic: Trusts - attribution of income & capital gains

77) Ian Home has a non-depreciable capital property that he purchased several years ago for $20,000. It has a current FMV of $30,000.

The following Six Scenarios are proposed for the transfer of this property by Ian to a trust. For each Scenario, indicate the income tax consequences to Ian at the time of the transfer, as well as the ACB of the property to the trust.

Scenario 1: Transfer to a joint spousal trust.

Scenario 2: Transfer to an inter vivos trust for a beneficiary that is a business partner.

Scenario 3: Transfer to a testamentary trust for a 22 year old son who is the only beneficiary.

Scenario 4: Transfer to a testamentary qualifying spousal trust.

Scenario 5: Transfer to an alter ego trust.

Scenario 6: Transfer to an inter vivos trust for a minor child who is the only beneficiary.

Answer: In those cases where a taxable capital gain will be recognized at transfer, the amount of the gain will be $5,000 [(1/2)($30,000 - $20,000)].

**Taxable Capital**

**Scenario Gain (Settlor) ACB (Trust)**

1. Joint spousal trust Nil $20,000

2. Inter vivos trust for business partner $5,000 30,000

3. Testamentary trust for 22 year old son 5,000 30,000

4. Testamentary qualifying spousal trust Nil 20,000

5. Alter ego trust Nil 20,000

6. Inter vivos trust for a minor child 5,000 30,000

Type: ES

Topic: Trusts - attribution of income & capital gains

78) Five years ago, a depreciable property was transferred from Mark's estate to a qualifying spousal trust created on his death. The property, which cost $224,000, had a UCC of $147,200 at the time of transfer. At the time of Mark's death, the property had a FMV of $262,400. Since then, the trust has claimed CCA of $15,400. At the end of the current year, the trust sold the property to an arm's length person for $243,200.

Determine the income tax consequences of the transfer of the depreciable property to the qualifying spousal trust and of the disposition of the property by the trust. Determine the maximum amount of trust income that can be allocated to Mark's spouse from the sale.

Answer:

**Transfer on Death -** Because of the available rollover to a qualifying spousal trust, the trust will be deemed to have acquired the depreciable property at a capital cost of $224,000 and to have claimed CCA of $76,800 resulting in an initial UCC of $147,200. The FMV at the time of Mark's death is not relevant since the transfer occurs on a rollover basis which effectively transfers the tax attributes of the depreciable property from the settlor/testator to the trust.

**Sale by Trust -** The income tax consequences of the sale by the trust would be as follows:

POD $243,200

Less: ACB ( 224,000)

Capital Gain $ 19,200

Inclusion Rate 1/2

Taxable Capital Gain $ 9,600

Capital Cost $224,000

UCC at Sale ($147,200 - $15,400) ( 131,800)

Recapture of CCA $ 92,200

All of the income from the sale can be allocated to Mark's spouse. This would be the taxable capital gain of $9,600 and the recaptured CCA of $92,200. As a result, the trust would have no net income or taxable income and therefore no federal income tax payable.

Type: ES

Topic: Trusts - spousal trusts & income allocation

79) Martine Flex died three years ago. At the time of her death, a depreciable property was transferred from her estate to a qualifying spousal trust that was created on her death. The property had a capital cost of $150,000 and it was the only property in its class. The balance in the class was $140,000. At the time of Martine's death, the property had a FMV of $180,000.

Since that time, the trust has claimed CCA of $20,000. At the end of the current year, the property is sold to an arm's length person for $205,000.

Determine the income tax consequences of the transfer of the property to the spousal trust and of the disposition of the property by the trust. Determine the maximum amount of trust income that can be allocated to Martine's spouse from the sale.

Answer:

**Transfer on Death -** Because of the available rollover to a qualifying spousal trust, the trust will be deemed to have acquired the depreciable property at a capital cost of $150,000, to have claimed CCA of $10,000 with the result that the UCC balance is $140,000. The FMV at Martine's death is not relevant since the transfer occurs on a rollover basis which effectively transfers the tax attributes of the depreciable property from the settlor/testator to the trust.

**Sale by Trust -** The income tax consequences of the sale by the trust would be as follows:

POD $205,000

Less: ACB ( 150,000)

Capital Gain $ 55,000

Inclusion Rate 1/2

Taxable Capital Gain $ 27,500

Capital Cost $150,000

UCC at ($140,000 - $20,000) ( 120,000)

Recapture of CCA $ 30,000

All of the income from the sale can be allocated to Martine's spouse. This would be the taxable capital gain of $27,500 and the recaptured CCA of $30,000. As a result, the trust would have no net income and taxable income and therefore no federal income tax payable.

Type: ES

Topic: Trusts - spousal trusts & income allocation

80) During the 2022 taxation year ending December 31, the Renaud family trust received eligible dividends from publicly traded Canadian corporations in the amount of $367,000. In addition, it received non-eligible dividends from the family owned CCPC in the amount of $108,000. Its only other 2022 income was a capital gain of $47,000 on a disposition of investments in publicly traded shares.

The only beneficiary of the trust is the family's 23 year old daughter, Francine Renaud. Francine is actively engaged in the CCPC on regular and continuous basis and, as a consequence, the TOSI is not applicable to the income that she receives from the trust. In 2022, $210,000 of the dividends from public companies, all of the dividends from the family's CCPC, and all of the $47,000 capital gain were distributed to Francine.

Indicate the income tax consequences of these transactions on the 2022 net income for both the trust and for Francine. In addition, calculate the 2022 federal dividend tax credit available to both the trust and Francine.

Answer: The income allocation would be as follows:

**Received Paid to Retained**

**by Trust Francine by Trust**

Eligible Dividends $367,000 $210,000 $157,000

Non-Eligible Dividends 108,000 108,000 Nil

Capital Gain 47,000 47,000 Nil

Totals $522,000 $365,000 $157,000

The 2022 net income of the trust would be calculated as follows:

Eligible Dividends $157,000

Gross Up at 38% 59,660

2022 Net Income - Trust $216,660

The 2022 net income for Francine would be as follows:

Eligible Dividends $210,000

Gross Up at 38% 79,800

Non-Eligible Dividends 108,000

Gross Up at 15% 16,200

Taxable Capital Gains [(1/2)($47,000)] 23,500

2022 Net Income - Francine $437,500

The dividend tax credit that will be available to the trust is $32,542 [(6/11)($59,660)]. Francine's dividend tax credits will be $43,527 [(6/11)($79,800)] on the eligible dividends and $11,215 [(9/13)($16,200)] on the non-eligible amounts.

Type: ES

Topic: Trusts - comprehensive problem: trust allocations to beneficiaries

81) The Weryk family trust is an inter vivos trust with one beneficiary. The beneficiary is 25 year old Marcin Weryk, the son of the settlor. In 2022, the trust received eligible dividends of $50,000 from the shares of publicly traded Canadian corporations. In addition, the trust received $200,000 in non-eligible dividends from a family owned CCPC. Marcin is actively engaged in the CCPC on a regular and continuous basis and, as a consequence, the TOSI would not apply to the income that he receives from the trust.

The trust sold shares in a public company, resulting in a capital gain of $30,000. 75% of both the trust's current year income and capital gains are distributed to Marcin.

Determine the effect of these transactions on the 2022 net income for both the trust and for Marcin.

Answer: The income allocation would be as follows:

**Received Paid to Retained**

**by Trust Marcin by Trust**

Eligible Dividends $ 50,000 $ 37,500 $12,500

Non-Eligible Dividends 200,000 150,000 50,000

Capital Gain 30,000 22,500 7,500

Totals $280,000 $210,000 $70,000

The 2022 net income of Marcin and the trust would be calculated as follows:

**Marcin Trust**

Eligible Dividends $ 37,500 $12,500

Gross-Up at 38% 14,250 4,750

Non-Eligible Dividends 150,000 50,000

Gross-Up at 15% 22,500 7,500

Taxable Capital Gain [(1/2)($30,000)] 11,250 3,750

2022 Net Income $235,500 $78,500

Type: ES

Topic: Trusts - comprehensive problem: trust allocations to beneficiaries

82) The sole income for 2022 of an inter vivos trust is $35,500 in non-eligible dividends received from a CCPC. The only beneficiary of the trust is the adult son of the settlor whose only income for 2022 is the dividends allocated from the trust. The son is actively engaged in the CCPC on a regular and continuous basis. He has no personal tax credits other than the BPA and any credits directly related to allocated trust income.

Calculate the 2022 net income, taxable income and federal income tax payable for both the trust and the beneficiary assuming:

A. The beneficiary was paid $24,500 of the dividend income.

B. The beneficiary was paid all of the dividend income.

Answer: 2022 net income, taxable income and federal income tax payable for the trust in Part A would be calculated as follows:

Non-Eligible Dividends $35,500

Deduction for distribution to Beneficiary ( 24,500)

Unallocated Dividend Income $11,000

Dividend Gross Up (15%) 1,650

Net Income & Taxable Income for the Trust $12,650

Federal Income Tax Rate (Inter Vivos Trust) 33%

Federal Income Tax before Credits $ 4,175

Federal Dividend Tax Credit [(9/13)($1,650)] ( 1,142)

2022 Federal Income Tax Payable - Trust (Part A) $ 3,033

Since in Part B, all of the dividends are paid to the beneficiary, the trust would have net income, taxable income, and federal income tax payable of nil.

2022 net income, taxable income, and federal income tax payable for the son would be calculated as follows:

**Part A Part B**

Non-Eligible Dividend Income allocated from the Trust $24,500 $35,500

Dividend Gross Up (15%) 3,675 5,325

Net Income & Taxable Income for the Son $28,175 $40,825

Federal Tax Rate 15% 15%

Federal Income Tax before Credits $ 4,226 $ 6,124

BPA [(15%)($14,398)] ( 2,160) ( 2,160)

Federal Dividend Tax Credit

[(9/13)(Gross Up)] ( 2,544) ( 3,687)

2022 Federal Income Tax Payable - Son Nil $ 277

By leaving $11,000 in dividends in the trust, $2,756 ($3,033 - $277) in avoidable federal income tax was paid.

Type: ES

Topic: Trusts - comprehensive problem: trust income & allocations to beneficiaries

83) The Fonda family trust is an inter vivos trust with one beneficiary, Liana, the 25 year old daughter of the settlor, Mr. Fonda. Liana has no income other than what she receives from the trust, and has no personal tax credits other than the BPA and any tax credits directly related to allocated trust income. The trust receives eligible dividend income of $100,000 in 2022 and does not distribute any of the dividends to Liana.

Determine the 2022 federal income tax payable for the trust.

Answer: The required calculations are as follows:

Eligible Dividends Received $100,000

Gross-Up on Eligible Dividends [($100,000)(38%)] 38,000

Net & Taxable Income - Trust $138,000

Flat Rate For Inter Vivos Trusts 33%

Income Tax before Credits $ 45,540

Dividend Tax Credit [(6/11)($38,000)] ( 20,727)

2022 Federal Income Tax Payable - Trust $ 24,813

Type: ES

Topic: Trusts - basic federal income tax payable (inter-vivos)

84) Martin Weryk died on January 1, 2022. While all of his estate will eventually be transferred to his spouse, Marta Weryk, on December 31, 2022, a significant portion of the estate is still under the administration of the executor.

The executor files a T3 annual income tax return for the 2022 taxation year ending December 31, designating the estate as a Graduated Rate Estate (GRE). The estate's income during the period January 1, 2022 to December 31, 2022 consists of non-eligible dividends in the amount of $200,000. Martin's will stipulates that while the estate is being administered by the executor, 50% of its income is to be distributed to his spouse Marta, with the balance accumulating in the estate. As per these instructions, $100,000 of the non-eligible dividends received are paid to Marta in December of 2022. Marta's only tax credits are the BPA, the age credit and any credits directly related to income allocated from the GRE.

Determine the 2022 federal income tax payable for both Marta and the GRE.

Answer: As this is a GRE, the calculation of its federal income tax payable will be based on the same graduated income tax rates that apply to individuals.

The 2022 net income iand taxable income for both Marta and the GRE would be the same as the dividends received are allocated 50:50 basis. The required calculations are as follows:

Non-Eligible Dividends [(50%)($200,000)] $100,000

Gross-Up On Non-Eligible Dividends [($100,000)(15%)] 15,000

2022 Net Income & Taxable Income $115,000

The 2022 federal income tax payable for Marta and the GRE would be calculated as follows:

**Marta Trust**

Tax on first $100,392 $17,820 $17,820

26% of $14,608

($115,000 - $100,392) 3,798 3,798

Tax Payable Before Credits $21,618 $21,618

Basic Personal Credit [(15%)($14,398)] ( 2,160) N/A

Age [(15%)($7,898) - (15%)($115,000 - $39,826)] N/A N/A

Dividend Tax Credit [(9/13)($15,000)] ( 10,385) ( 10,385)

2022 Federal Income Tax Payable $ 9,356 $ 11,427

Type: ES

Topic: Trusts - basic federal income tax payable (GRE)

85) Last year, Martine Brown transferred to a family trust, for no consideration, bonds that pay annual interest of $108,000. The beneficiaries of the trust are Martine's spouse, Michael, and their two children, Rachel (16 years old) and Dirk (22 years old). The beneficiaries have no income other than income allocated from the trust. The trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. The trust also realized a capital gain of $36,000 on the trust disposition of one of the bonds late in the year.

Determine the net income and taxable income of each beneficiary and calculate any effect the trust income will have on Martine's income. Ignore the possibility that some of the income received by the beneficiaries may be subject to the TOSI.

Answer: Interest Income on the bonds is property income and is therefore subject to the attribution rules to the extent that the income is allocated to Martine's spouse, Michael, or to their minor daughter, Rachel. This means that two-thirds of the interest will be attributed back to Martine. With respect to the capital gain, the attribution rules do not apply on transfers to minors. This means that only Michael's one-third share of the capital gain will be attributed back to Martine.

The increase in net income and taxable income for Martine and the trust's beneficiaries are as follows:

**Attributed**

**Michael Rachel Dirk To Martine**

Interest Income ($108,000 ÷ 3) $36,000 $36,000 $36,000 Nil

Interest Attribution to Martine ( 36,000) ( 36,000) Nil $72,000

Taxable Capital Gain

[(1/2)($36,000) ÷ 3] 6,000 6,000 6,000 Nil

Taxable Capital Gain Attributed to Martine ( 6,000) Nil Nil 6,000

2022 Net Income & Taxable Income Nil $6,000 $42,000 $78,000

Type: ES

Topic: Trusts - attribution of income & capital gains

86) In 2022, Devon Jenkins transferred to a family trust, for no consideration, publicly traded shares that paid eligible dividends of $72,900 to the trust in the 2022 taxation year ending December 31. The beneficiaries of the trust are Devon's spouse, Connie, and their two children, Marvin (16 years old) and Diane (22 years old). The beneficiaries have no income other than income allocated from the trust. In 2022, the trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. In addition to the dividends, there was a 2022 disposition of shares by the trust that resulted in a capital gain of $16,200.

Determine the 2022 net income and taxable income of each beneficiary and calculate any effect the trust income will have on the taxable income of Devon. Ignore the possibility that some of the income received by the beneficiaries may be subject to the TOSI.

Answer: The dividend income is income from property and therefore subject to the attribution rules to the extent that the income is allocated to Devon's spouse, Connie, and to their minor son, Marvin. This means that two-thirds of the dividends will be attributed back to Devon. As well, Connie's share of the taxable capital gain is attributed back to Devon.

The increase in the 2022 net income and taxable income for Devon and the trust's beneficiaries are as follows:

**Attributed**

**Connie Marvin Diane To Devon**

Eligible Dividends ($72,900 ÷ 3) $24,300 $24,300 $24,300 Nil

Dividend Attribution to Devon ( 24,300) ( 24,300) Nil $48,600

Net Dividends Nil Nil $24,300 $48,600

Dividend Gross Up at 38% Nil Nil 9,234 18,468

Taxable Capital Gain

[(1/2)($16,200) ÷ 3] 2,700 2,700 2,700 Nil

Taxable Capital Gain Attributed to Devon ( 2,700) Nil Nil 2,700

2022 Net Income & Taxable Income Nil $ 2,700 $36,234 $69,768

Type: ES

Topic: Trusts - attribution of income & capital gains

87) The Barton family trust was established when Mrs. Barton transferred publicly traded shares with an ACB of $187,000 and a FMV of $312,000 to a trust for no consideration. The beneficiaries of the trust are Mrs. Barton's two daughters, Sarah, aged 25, and Mary, aged 27. They have an equal interest in the income and capital of the trust.

At the beginning of the current year, Mary sells her capital interest in the trust to Sarah. There have been no capital distributions from the trust. At the time of the sale, the FMV of the shares in the trust is $409,000. Based on this, the transfer amount for the capital interest is $204,500 [(1/2)($409,000)].

Determine the income tax consequences of this transaction to each of the sisters.

Answer: With respect to Sarah, she has acquired a capital interest for consideration of $204,500. This will be the ACB of the interest she has acquired.

With respect to Mary, she has disposed of a capital interest for POD of $204,500. Since she did not purchase the interest in the trust, her ACB as usually determined would be nil. However, for this disposition, the ACB of the capital interest is the greater of nil and the cost amount as determined under ITA 108(1). The cost amount would be $156,000, one-half of the $312,000 tax cost of the trust property. The result would be a taxable capital gain of $24,250 [(1/2)($204,500 - $156,000)].

Type: ES

Topic: Trusts - capital property distributions (ITA 107(2))

88) At the beginning of 2022, Connie McGuire transferred publicly traded shares to a family trust. Connie's ACB of the shares was $240,000 and they had a FMV at the time of transfer of $300,000. The trust's beneficiaries are Connie's two sons, Bart and Billy. They are both in their early 30s.

During the remainder of 2022, the shares paid eligible dividends $38,000, all of which were distributed equally to the two beneficiaries during the year. There are to be no capital distributions from the trust for 5 years.

In early 2022, Bart sells his capital interest to Billy. At that time, the shares have a FMV of $420,000. Based on this, Bart pays $210,000 to Billy for his interest.

Determine the income tax consequences of this transaction to each of the brothers.

Answer: Billy has acquired a capital interest for consideration of $210,000. This would be the ACB of his purchased capital interest.

Correspondingly, Bart has disposed of his capital interest for consideration of $210,000. This would be his POD. His ACB as usually determined would be nil. However, for this disposition, the ACB of the capital interest is the greater of nil and the cost amount as determined under ITA 108(1). This cost amount would be $150,000 [(1/2)($300,000)]. Given this, Bart will have a taxable capital gain of $30,000 [(1/2)($210,000 - $150,000)].

Type: ES

Topic: Trusts - capital property distributions (ITA 107(2))

89) Fred Kemper owns investments which pay annual interest of $150,000. He has other income in excess of $300,000. He has three sons who are triplets. They are 25 years old and currently have no other income. Their only tax credit is the BPA. The trust will be required to distribute all of its income on an annual basis. Ignore the possibility that some of the income received by the beneficiaries may be subject to the TOSI.

Determine the 2022 savings in federal income tax that could be achieved by transferring the investments to a family trust with the triplets as equal beneficiaries.

Answer: As Fred's other income places him in the maximum federal income tax bracket of 33%, his federal income tax savings resulting from transferring ownership of the securities to the family trust would be $49,500 [($150,000)(33%)]. The federal income tax that would be payable on the additional $50,000 received by each of the triplets is as follows:

Tax on $50,000 at 15% $7,500

BPA [(15%)($14,398)] ( 2,160)

2022 Federal Income Tax Payable $5,340

The total federal income tax payable by the triplets would be $16,020 [($5,340)(3)]. This is $33,480 ($49,500 - $16,020) per year less in federal income tax than the amount that would be paid by Fred without the trust.

Type: ES

Topic: Trusts - income tax planning

90) Darlene Knight has annual employment income in excess of $250,000. In addition, she has a portfolio of investments that earn annual interest income of $120,000. The FMV of the investments is equal to their ACB. Darlene has two sons, both of whom are over 18 years of age. However, they have no income of their own and continue to live at home. Their only tax credit is the BPA. Darlene plans to create a trust by contributing the investments to an arm's length trustee with her two sons as the only two beneficiaries who will share all trust income equally. Ignore the possibility that some of the income allocated to the beneficiaries may be subject to the TOSI.

Determine the 2022 income tax savings in federal income tax that could be achieved by transferring the ownership of the investments to a family trust.

Answer: With her employment income in excess of $250,000, any additional income earned by Darlene will be subject to the maximum federal income tax rate of 33%. This means that, on $120,000 of interest income, she would pay federal income tax of $39,600 [(33%)($120,000)].

If she establishes the family trust, each of her sons will receive income of $60,000. The 2022 federal income tax payable on this amount would be calculated as follows:

Tax on first $50,197 $7,530

Tax on Additional $9,803 ($60,000 - $50,197) at 20.5% 2,010

Tax Before Credit $9,540

Personal Credit [(15%)($14,398)] ( 2,160)

2022 Federal Income Tax Payable $7,380

The total federal income tax payable by her sons would be $14,760 [(2)($7,380)]. This is $24,840 ($39,600 - $14,760) less than the federal income taxes that Darlene would have paid on the $120,000 of interest income without the use of a trust.

Type: ES

Topic: Trusts - income tax planning

91) Each of the following independent Cases involve transfers of property to trusts by a settlor for no consideration. Three of the Cases also involve capital distributions from trusts to capital beneficiaries.

A. A non-depreciable capital property is transferred to an alter ego trust. The ACB of the property to the settlor was $75,400. On the date of the transfer, the estimated FMV is $62,000. At a later point in time, when the estimated FMV of the property has increased to $73,000, the property is transferred back to the settlor.

B. A transfer of a non-depreciable capital property is made to a qualifying spousal testamentary trust. The ACB of the property to the deceased spouse was $32,600, and the FMV on the date of the transfer to the trust is $46,500. At the time of death, the deceased had a net capital loss balance in excess of $15,000.

C. A gift of non-depreciable capital property is made to an inter vivos trust in favour of the settlor's adult children. The ACB of the property to the settlor was $13,400.and the FMV on the date of the gift is $15,800. At a later point in time, when the FMV of the property is $17,300, the property is distributed by the trust to the children.

D. A gift of depreciable property is made to an inter vivos trust in favour of the settlor's adult children. The capital cost of the depreciable property to the settlor was $8,000. On the date of the gift, the UCC was $6,250 and the FMV $9,400.

E. A gift of non-depreciable capital property is made to a qualifying spousal inter vivos trust. The ACB of the property to the settlor was $23,500. At the time of the transfer the FMV of the property is $27,600. At a later point in time, the property is distributed by the trust to the spouse. At that time the FMV of the property is $28,800.

F. A depreciable property is transferred to an inter vivos trust in favour of the settlor's adult children. The capital cost of the property is $5,600 and its UCC is $4,200. It is the last property in its class. At the time of the transfer, the FMV of the property is $2,000.

**Required:** For each Case indicate:

1. The income tax consequences to the settlor that result from the transfer of the property to the trust assuming, where possible, a transfer price is chosen to optimize the income tax consequences to the settlor.

2. The tax cost of the transferred property to the trust.

3. In those cases where property is transferred to a beneficiary (a capital distribution), the income tax consequences to the trust and the tax cost to the beneficiary.

Answer:

***Case A***

**Rollover** - While many transfers of property to a trust take place at FMV there are certain situations where the property transfer can occur on a rollover basis. Transfers to an alter-ego trust are one of a select few that are recognized on a rollover basis. An election is available to forego the rollover in which case a FMV default rule would apply. If no FMV election is made, the results are as follows:

1. The deemed POD for the settlor would be the ACB of $75,400, resulting in no capital gain or capital loss on the transfer.

2. The trust acquires the property at a deemed cost of $75,400.

3. The property will be transferred to the settlor at the $75,400 ACB of the trust. This will also be the tax cost to the settlor.

**Election For No Rollover** - If the FMV election is made the results are as follows:

1. There is a loss of $13,400 ($75,400 - $62,000) on the transfer to the alter ego trust. However, the settlor and the trust are affiliated persons [ITA 251.1(1)] and, as a consequence the loss would be disallowed.

2. While the transfer is made at the FMV of $62,000, the settlor was an individual. Given this, the disallowed loss will be added to this ACB of the property to the alter ego trust which would be $75,400 ($62,000 + $13,400).

3. As the transfer is back to the settlor, it will be transferred at the $75,400 ACB of the trust. This will also be the ACB to the settlor.

***Case B***

1. Under the general ITA 70(6) rollover, the deemed POD to the deceased would be the property's ACB of $32,600, resulting in no capital gain or capital loss on the transfer. As the deceased has a net capital loss balance, a better alternative could be to elect out of ITA 70(6) and transfer the property at its FMV of $46,500. This will result in a taxable capital gain of $6,950[(1/2)($46,500 - $32,600)] that would be offset in full with the use of the net capital loss. This would reduce the net capital loss to $8,050 ($15,000 - $6,950).

Note that in the year of death, net capital loss balances can generally be deducted against any type of income (ITA 111(2)). If the deceased has other income against which the net capital loss can be deducted, it may not be advantageous to elect out of the rollover. More information on the spouse's current and future taxable income would be needed to optimize the use of any net capital loss balance.

2. Under the general ITA 70(6) rollover provision, the ACB to the trust would be $32,600. If the FMV election is made, the spousal trust will have acquired the property at a deemed cost of $46,500. This higher amount will serve to reduce any future gain on the property when sold by the trust.

***Case C***

1. The settlor has deemed POD equal to the FMV of $15,800. This will result in the settlor realizing a taxable capital gain of $1,200 [(1/2)($15,800 - $13,400)]. There is no rollover available for this situation.

2. The deemed ACB to the trust will also be the FMV of $15,800.

3. The property will be transferred to the children at the trust's ACB of $15,800. There will be no income tax consequences for the trust as a result. The children will be deemed to have acquired the property for the trust's ACB of $15,800.

***Case D***

1. The settlor has deemed POD equal to the FMV of $9,400, resulting in a taxable capital gain of $700 [(1/2)($9,400 - $8,000)]. In addition, there will be recapture of CCA of $1,750 ($8,000 - $6,250).

2. The trust acquires the property at a cost of $9,400, however, for purposes of calculating CCA and recapture, the ITA 13(7)(e) rules for non-arm’s length transactions apply and the capital cost will be $8,700 [$8,000 + (1/2)($9,400 - $8,000)]. Since all of the CCA has been recaptured there is no deemed capital cost and deemed CCA to match the tax characteristics of the property to the settlor.

***Case E***

1. Under the ITA 73(1) rollover provision, the deemed POD to the settlor would be the property’s ACB of $23,500, resulting in no capital gain or capital loss on the transfer.

2. Under the ITA 73(1) rollover, the ACB to the trust would be the same $23,500.

3. The transfer (ITA 107(2)) will be at the ACB of the property to the trust of $23,500. There will be no income tax consequences for the trust or the spouse. The deemed POD to the trust and ACB to the spouse will be $23,500. Any income or loss of the property or capital gain or loss on the sale of the property by the spouse will be attributed to the settlor.

***Case F***

1. The settlor has deemed POD equal to the FMV of $2,000, resulting in a terminal loss of $2,200 (UCC of $4,200 minus the lesser of capital cost of $5,600 and POD of $2,000). In this case the settlor is not affiliated with the trust since the settlor is not a majority interest beneficiary nor is the settlor affiliated with a majority interest beneficiary since parents and children are not affiliated. As a result the loss denial rule of ITA 13(21.2) does not apply.

2. Since the settlor is non-arm's length with the trust because of the fact that the settlor is related to the beneficiaries of the trust then the rules of ITA 13(7)(e) apply to restrict the tax costs of the depreciable property to the trust. As a result the capital cost of the property is deemed to be equal to the capital cost of $5,600 to the settlor and there is also deemed CCA of $3,600 ($5,600 less the FMV at the time of transfer of $2,000) which results in a UCC of $2,000. This rule ensures that any subsequent increase in the FMV of the property will potentially ensure that the $3,600 difference is subject to recapture treatment rather than being treated as a capital gain.

Type: ES

Topic: Trusts - six mini-cases: property transfers to & from a trust

92) In the process of planning an estate freeze, Gerald Butler intends to establish a trust with his investments. The terms of this trust will require that, on an annual basis, 50% of the income of the trust be distributed to his spouse, Inara Dickson, with the remaining 50% going to their son, Barry. Barry is 25 years old and has annual employment income of $35,000.

The trust's income will consist of interest, taxable dividends, and capital gains.

The terms of the trust require that all of the property of the trust be distributed on the tenth anniversary of the trust. This distribution will use the same 50:50 annual income distributions.

**Required:**

A. Identify the type of trust that is being used.

B. Indicate what the trust's taxation year end date will be.

C. Indicate the persons who will be required to include the income of the trust in their income.

D. Explain how your answer to Part C would change if Mr. Butler establishes the trust with a nominal amount of cash. Mr. Butler then lends money to the trust to purchase the investments from him at FMV.

E. Explain how the taxation of the trust income will change if Mr. Butler and Mrs. Dickson were living separate and apart because of a breakdown in their marriage.

Answer:

A. The trust is an inter vivos trust in that it was established by an individual during that individual's lifetime. In less technical terms, it could also be described as a family trust in that all of the beneficiaries are family members. In addition, it could be referred to as a non-discretionary trust since there is no latitude by the trustee in deciding how much income will be distributed to beneficiaries.

B. As the trust is an inter vivos trust, the taxation year end must be December 31.

C. All of the income that is allocated to Inara will be subject to the income attribution rules. As a consequence, it will be included in Mr. Butler's income. This includes interest and dividends earned by the trust and capital gains realized by the trust.

As Barry is over the age of 17, the attribution rules will not apply to his share of the trust's income. This means that the income that is paid or payable to him will be included in his income.

As all of the trust's income is either attributed back to Mr. Butler or paid or payable to a beneficiary, the net income of the trust will be nil.

D. The answer here will depend on the terms of the loan to the trust as the attribution rules for non-arm's length loans must be considered. If it is an interest free loan, the results will be the same as in Part C. That is, the income allocated to Ms. Dickson will be attributed back to Mr. Butler, while the income allocated to Barry will be included in his own income. This would also be the result if the interest rate on the loan was less than the prescribed interest rate.

Alternatively, if the loan bears interest at the prescribed interest rate or higher, the income attribution rules would not apply and the trust income allocated to Ms. Dickson would be included in her income. Note that the loan would have to have bona fide repayment terms and the annual interest for the year would have to be paid within 30 days of the end of each calendar year.

E. The income attribution rules do not apply to any income, loss, capital gain or capital loss that relates to the period throughout which the individuals are living separate and apart because of a breakdown of their marriage or common-law partnership (ITa 74.5(3)).

Type: ES

Topic: Trusts - comprehensive problem: inter vivos trusts - income attribution

93) Genevieve Marcoux is a biochemist who earns annual employment income of $250,000. In addition, she has $40,000 in annual interest income from an $800,000 term deposit she inherited.

Genevieve is a single mother with two children. Her daughter, Lisa, is 21 years old and attends university in the U.S. Lisa plans to become a medical doctor and expects to attend university for another seven years. Lisa's tuition and books cost $30,000 (Canadian) each year. Genevieve's son, Philip, is one year old, and is cared for by a nanny who is paid $14,500 a year.

When Philip is five years old, Genevieve intends to send him to a private school, and the fees will be comparable to the cost of a nanny. In addition, Genevieve incurs $500 each month in direct expenses for each child, totaling $12,000 a year. Genevieve does not expect either Lisa or Philip to earn any income until they complete university.

Genevieve would like to contribute the term deposit to a trust for her children as the sole beneficiaries, so the family can benefit from income splitting currently, and in the future. While she supports her children fully, she does not want them to receive any cash directly from the trust until they are each 35 years old. Until then, she wants the trust to pay for their care, education, and other direct expenses.

**Required:** Outline how a trust might be used to split income among Genevieve's family members.

Answer: A trust can be used to split income in these circumstances. However, there are complications. First, as this is an inter vivos trust, any income that remains in the trust will be subject to a federal income tax rate of 33%. Since this is the same income tax rate that applies to Genevieve, there is little point in transferring property to a trust without distributing all of the income to lower income individuals. In other words the goal is to ensure that trust net income and taxable income are nil.

There is no problem with allocating trust income to Genevieve's daughter, Lisa, as she is over 17 years old. As she has no other income, there would be significant income tax savings, even if the entire $40,000 was distributed to her. However, as Philip is under 18, any distributions of trust income to him will be attributed to Genevieve. This means that there is no immediate income tax advantage associated with allocations of trust income to Philip. Note, however, there is a long run advantage in that, when the attributed earnings are reinvested, there is no attribution with respect to the compound earnings resulting from the reinvestment.

These considerations make it clear that, if a trust is going to be used, all of the income should be paid, or made payable, to Lisa, at least until Philip reaches 18 years of age. If the $40,000 exceeds the amount that Genevieve wishes Lisa to receive, the amount of property transferred to the trust could be reduced.

With Lisa attending university in the U.S., it is likely that she will require at least the full $40,000 to cover tuition, books, and living expenses. Given this, there would be excellent tax benefits associated with allocating the full $40,000 of trust income to Lisa, at least for the period of time that she is in university. The allocated income could be used to pay for her university costs, with the related education tax credits and her BPA eliminating most, or all, of any income tax on the $40,000. Since Genevieve does not wish Lisa to receive cash from the trust, the trust could pay for her tuition and living costs directly. The amount of education costs paid by the trust would be treated as an allocation of trust income in that same amount.

Given the fact that it is not currently tax efficient to allocate income to Philip, Genevieve may wish to establish a discretionary trust. This would allow her to change the pattern of distributions once Philip reaches 18 years of age. At that time, it might be possible to use the trust to support his university education.

As the trust life is expected to extend beyond 21 years (until Philip turns 35), a deemed disposition of all trust property will occur in 21 years. If the trust continues to invest in term deposits or similar investments, the deemed disposition will not be onerous since the FMV of these investments generally equals their tax cost. However, if the trust invests in securities that could have unrealized capital gains, this rule would require recognition of these gains. Standard tax planning to avoid the 21 year dispositions are to make capital distributions of property immediately prior to the 21 year anniversary date.

Type: ES

Topic: Trusts - comprehensive problem: tax planning with family trusts

94) Several years ago, Victoria Firth contributed some of her investments to an inter vivos trust in favour of her two adult children who were the only beneficiaries. The taxation year of the trust is December 31.

The terms of the trust specify that her son Mark is to receive 30% of all of the income of the trust, while her son Steven is to receive 40%. Mark is 22 years old and Steven is 28. Both children are single and have no income other than income allocated to them by the trust.

The undistributed income is to accumulate within the trust, to be paid out to the children at the time of Ms. Firth's death.

The trust income for the 2022 taxation year, are as follows:

Interest income on GICs $ 96,450

Non-Eligible Dividends 326,940

Rental Income 43,680

In 2022, the rental property was sold. The property consisted of an apartment building and the land on which it was located, all of which had been contributed to the trust when it was first established. The relevant information related to the disposition is as follows:

**Building Land**

POD $1,500,000 $625,000

UCC 1,253,000 N/A

Capital Cost/ACB 1,400,000 375,000

This is the first disposition of capital property by the trust.

**Required:**

A. Calculate the 2022 net income and taxable income of the trust, Mark Firth, and Steven Firth.

B. Calculate the trust's 2022 federal income tax payable.

Answer:

***Part A - Calculation of 2022 Net Income & Taxable Income***

All amounts are allocated 30% to Mark, 40% to Steven, with the remaining 30% included in the income of the trust. The net income and taxable income of the two beneficiaries and the trust would be calculated as follows:

**Mark (30%) Steven (40%) Trust (30%)**

Interest on GICs ($96,450) $ 28,935 $ 38,580 $ 28,935

Non-Eligible Dividends ($326,940) 98,082 130,776 98,082

Gross Up 15% ($49,041) 14,712 19,616 14,712

Taxable Capital Gain on Land

[(1/2)($625,000 - $375,000)] 37,500 50,000 37,500

Taxable Capital Gain on Building

[(1/2)($1,500,000 - $1,400,000)] 15,000 20,000 15,000

Rental Income (Note) 57,204 76,272 57,204

2022 Net Income & Taxable Income $251,433 $335,244 $251,433

Note - The rental income, including the recapture of CCA, can be calculated as follows:

Income from Rental Property $ 43,680

Recapture of CCA:

Capital Cost of The Building $1,400,000

UCC ( 1,253,000) 147,000

Rental Income $190,680

***Part B - 2022 Federal income Tax Payable - Trust***

Federal income Tax before Credits [(33%)($251,433)] $82,973

Federal Dividend Tax Credit [(9/13)($14,712)] ( 10,185)

2022 Federal Income Tax Payable $72,788

As this trust is an inter vivos trust, all of its income is subject to federal income tax rate of 33%.

Type: ES

Topic: Trusts - comprehensive problem: trust income & allocations to beneficiaries

95) Mr. Hyde died on January 1, 2022. His will specifies that the property in his estate is to be transferred to a testamentary trust. Mr. Hyde received all of his investment reporting online and, because no-one knew his passwords or where his investments were held, his executor experienced great difficulties in trying to locate them all.

At December 31, 2022, the transfer has not yet been implemented. The executor will file a T3 income tax return for the 2022 taxation year period ending December 31 designating Mr. Hyde's estate as a Graduated Rate Estate (GRE).

The beneficiaries of the GRE are Mrs. Hyde, an architect earning more than $250,000 per year, and her son, Ross, an unemployed actor with no reliable source of income. Ignore the fact that one or both of these beneficiaries could be subject to the TOSI.

Mr. Hyde's will made a provision for income distributions to be made to beneficiaries while his estate is being administered by an executor. While the provision allows for distributions to either beneficiary, the amounts and timing are at the discretion of the executor.

For the 2022 taxation year, the GRE had the following income:

Interest income $24,000

Eligible Dividends 29,000

Total Income $53,000

**Required:**

A. With a view to minimizing total federal income tax payable of the GRE and the beneficiaries, determine the amounts and type of income that should be distributed to each beneficiary for 2022.

B. Using the allocations you determined in Part A, calculate the federal income tax payable for the GRE and Ross for the 2022 taxation year. In addition, indicate any additional income tax that would be paid by Mrs. Hyde for 2022 as the result of GRE distributions.

Answer:

**Part A - Amounts & Type of Income to be Distributed**

***Relative Tax Status***

In attempting to minimize the federal income tax payable to the GRE and the beneficiaries, the relative tax status of the persons is relevant.

**Mrs. Hyde -** As Mrs. Hyde has substantial amounts of other income, any income paid to her by the GRE will be subject to the maximum federal income tax rate of 33%.

**Ross Hyde -** As Ross has no other income in 2022, any income paid to him is likely to be subject to federal income tax rates of 15%.

**GRE -** As the GRE status is available for 2022, any income retained by the GRE will be subject to the same graduated federal income tax rates that apply to individuals starting at the lowest federal income tax rate of 15%. We would note that the GRE status will end on December 31, 2024, even if the estate has not been fully administered. When this occurs any trust income subsequent to that time will be subject to the maximum federal income tax rate of 33%.

***Dividend Income***

With respect to eligible dividends, the gross up and tax credit mechanism provide significantly reduced income tax rates for all individuals. The relevant information for the GRE and the two beneficiaries is as follows:

**GRE -** As the trust has GRE status in 2022, it can receive up to approximately $35,000 of eligible dividends without paying any federal income tax.

**Ross -** As Ross has a BPA of $2,160 [(15%)($14,398)], the amount of tax free eligible dividends that he can receive increases to almost $63,000.

**Mrs. Hyde -** As Mrs. Hyde already has income in excess of $250,000, any eligible dividends that she receives will be subject to a federal income tax rate of 24.8% [(33%)(138%) - (6/11)(38%)].

***Interest Income***

While Ross could receive up to $14,398 (the BPA amount) of interest income on a tax free basis, any additional amounts would be subject to a federal income tax rate of 15%. This 15% rate would also be available to the GRE on any unallocated trust income. This is well below the 33% federal income tax rate that would apply to interest income paid to Mrs. Hyde from the GRE.

***Conclusion***

For both interest and dividends, the income tax rate for Mrs. Hyde is much higher than that the rate that would apply to either Ross or the GRE. Given this, if income tax minimization is the objective, no distributions should be made to Mrs. Hyde. As her other income is likely more than sufficient to meet her needs, this decision should not cause a financial burden for her.

With respect to Ross and the GRE, either person could receive all of the dividends without paying any federal income tax. However, because Ross has a BPA available, he could receive, in addition to the dividends, a larger amount of the interest while still not paying any federal income tax. This would suggest distributing all of the dividends to Ross, along with sufficient interest to reduce his federal income tax payable to nil. Any remaining interest would be left in the GRE subject to the minimum federal income tax rate of 15%.

The after-tax funds in the GRE can be distributed tax free to either beneficiary.

**Part B - Federal income Tax Payable**

***Ross***

If Ross receives all of the dividends, his federal dividend tax credit would be $6,011 [(6/11)(38%)($29,000)]. When combined with his BPA of $2,160, he would have total credits of $8,171 ($6,011 + $2,160). For his federal income tax payable before credits to be equal to this amount, his taxable income would have to be $53,322. This amount is represented by X in the following calculation:

$8,171 = $7,530 + [(20.5%)(X - $50,197)]

$8,171 = $7,530 + [(20.5%)(X)] - $10,290

$10,931 = [(20.5%)(X)]

X = $53,322

Subtracting the grossed up dividends of $40,020 [(138%)($29,000)] from this required taxable income amount leaves $13,302 ($53,322 - $40,020) to be distributed to Ross as interest.

Ross' 2022 Federal income Tax Payable would be nil as shown in the following calculation.

Tax on first $50,197 $ 7,530

Tax on next $3,125 ($53,322 - $50,197)] at 20.5% 641

Tax Before Credits $8,171

BPA [(15%)($14,398)] ( 2,160)

Dividend Tax Credit [(6/11)(38%)($29,000)] ( 6,011)

2022 Federal Income Tax Payable Nil

Note that the Federal income Tax Payable is exactly nil, with no unused credits remaining.

***GRE***

With all of the taxable dividends and $13,302 of the interest income allocated to Ross, this would leave $10,698 ($24,000 - $13,302) of the interest to be subject to federal income tax to the GRE of $1,605 [(15%)($10,698)].

***Mrs. Hyde***

As no distribution will be made to Mrs. Hyde, her 2022 Federal Income Tax Payable will be unchanged by the existence of the GRE.

Type: ES

Topic: Trusts - comprehensive problem: graduated rate estates (GRE)

96) Last year, Mr. Jerry Hall established an inter vivos trust for his 22 year old son, Mark Hall. The trust agreement leaves to the discretion of the trustees the portion of each type of the trust's income that will be distributed each year. During the 2022 taxation year ending December 31, the following amounts of income were earned by the trust:

Interest from Canadian sources $ 18,500

Capital Gains 43,000

Eligible Dividends 32,000

Rental Income 19,500

2022 Trust Income before Allocations $113,000

In 2022, the trustees allocated all of the interest income to Mark, as well as 80% of the capital gains, taxable dividends, and rental income. Ignore the possibility that amounts received by Mark could be subject to the TOSI.

Mark is a full time student for 12 months of 2022 and his tuition for the year was $12,500. He has no other income for 2022.

**Required:** Calculate 2022 net income, taxable income and federal income tax payable for both the trust and for Mark. In addition, comment on whether it was advantageous for the trustees to leave 20% of the capital gains, taxable dividends, and rental income in the trust.

Answer:

***Calculations***

Taxable Income for the trust and for Mark would be calculated as follows:

**Trust Mark**

Interest Income Nil $18,500

Taxable Capital Gains:

[($43,000)(1/2)(20%)] $ 4,300

[($43,000)(1/2)(80%)] 17,200

Eligible Dividends:

[($32,000)(20%)] 6,400

[($32,000)(80%)] 25,600

Gross Up on Eligible Dividends:

[($32,000)(38%)(20%)] 2,432

[($32,000)(38%)(80%)] 9,728

Rental Income:

[($19,500)(20%)] 3,900

[($19,500)(80%)] 15,600

2022 Net Income & Taxable Income $17,032 $86,628

The 2022 federal income tax payable for the trust would be calculated as follows:

Taxable Income $17,032

Federal Income Tax Rate 33%

Federal Income Tax Payable before Dividend Tax Credit $ 5,621

Dividend Tax Credit [(6/11)($2,432)] ( 1,327)

2022 Federal Income Tax Payable — Trust $ 4,294

The 2022 Federal income Tax Payable for Mark would be calculated as follows:

Tax on first $50,197 $ 7,530

Tax on next $36,431 ($86,628 - $50,197) at 20.5% 7,468

Federal Income Tax Before Credits $14,998

Tax Credits:

Personal ($14,398)

Tuition ( 12,500)

($26,898)

Rate 15% ( 4,035)

Dividend Tax Credit [(6/11)($9,728)] ( 5,306)

2022 Federal Income Tax Payable — Mark $ 5,657

***Comment***

The $17,032 of income that was retained in the trust was subject to a federal income tax rate of 33%, before consideration of the dividend tax credit. If the income had been distributed to Mark, it would have been subject to a federal income tax rate of only 20.5%, before consideration of the dividend tax credit, resulting in a $2,129 [($17,032)(33% - 20.5%)] reduction in federal income tax payable. Based on income tax considerations only, retention of the income in the trust was not advantageous.

Type: ES

Topic: Trusts - comprehensive problem: trust income & allocations to beneficiaries

97) After a long illness, Marlene Scopal passed away on April 4, 2022. Her will requires that all of the property of her estate be transferred to a testamentary trust with her two children, Marilyn, her 32 year old daughter and Murphy, her 24 year old son as beneficiaries. However, because of complications in making the transfer to the trust, on December 31, 2022, the estate is still under the administration of the executor.

The executor files a T3 income tax return, designating Marlene's estate as a Graduated Rate Estate (GRE) for the 2022 taxation year ending on December 31. While the executor could have chosen a non-calendar taxation year, it was decided to use December 31 for convenience.

The information on the property owned by Marlene at the time of her death is as follows:

**Tax Cost FMV**

**ACB & UCC April 4, 2022**

Public Company Shares $1,856,000 $2,342,000

Government of Canada Bonds 562,000 562,000

Rental Property

Land 865,000 989,000

Building (Cost = $1,250,000) 932,000 1,560,000

The tax costs of all property except the building are the ACB. The UCC is shown for the building.

As Marlene had anticipated difficulty in settling the estate her will directed that any income that accrues to her estate prior to the settlement of the estate should be distributed 35% to Marilyn and 45% to Murphy, with the remaining 20% subject to income tax by the GRE.

Between April 4, 2022 and December 31, 2022, the GRE had the following income:

Eligible Dividends $123,670

Interest income on Bonds 22,490

Rental Income:

Rental Revenues $192,460

Rental Expenses other than CCA ( 49,450)

CCA Claimed ( 42,100) 100,910

2022 Total Estate Income $247,070

**Required:**

A. Determine the increase in Marlene's 2022 net income as a result of her death.

B. For the taxation year ending on December 31, 2022, determine the net income and taxable income for the GRE and for each beneficiary.

C. Calculate the 2022 federal income tax payable for the GRE.

Answer:

***Part A - 2022 Increase in Net Income***

As a consequence of death, there would be a deemed disposition of capital property, resulting in the following increase in net income:

Capital Gain on Public Company Shares

($2,342,000 - $1,856,000) $486,000

Capital Gain on Government of Canada Bonds Nil

Capital Gain on Land ($989,000 - $865,000) 124,000

Capital Gain on Building ($1,560,000 - $1,250,000) 310,000

Total Capital Gains $920,000

Inclusion Rate 1/2

Taxable Capital Gains $460,000

Recapture on Building ($1,250,000 - $932,000) 318,000

2022 Increase in Net Income $ 778,000

**Note -** The ITA 13(7)(e) provision which limits the capital cost of depreciable property for CCA purposes to the transferor's cost, plus one-half of any capital gain that results from the transfer, does not apply to non-arm's length transfers of depreciable property on death.

***Part B - 2022 Taxable Income - The GRE & Beneficiaries***

The allocations required by the will are as follows:

**Marilyn (35%) Murphy (45%) GRE (20%)**

Eligible Dividends Received

($123,670) $ 43,284 $ 55,652 $24,734

Gross Up of 38% ($46,995) 16,448 21,148 9,399

Interest on Bonds ($22,490) 7,872 10,121 4,498

Rental Income ($100,910) 35,319 45,410 20,182

2022 Net Income and Taxable Income $102,923 $132,331 $58,813

***Part C - 2022 Federal Income Tax Payable - GRE***

Income that remains in a GRE is subject to the same graduated federal income tax rates that apply to individuals. However, the GRE would not be able to use personal tax credits under ITA 118 to reduce the amount of federal income tax payable.

2022 Federal Income Tax Payable for the GRE would be calculated as follows:

Federal Income Tax Payable on first $50,197 $7,530

Federal Income Tax Payable on next $8,616

($58,813 - $50,197) at 20.5% 1,766

Federal Tax Payable Before Credits $9,296

Federal Dividend Tax Credit [(6/11)($9,399)] ( 5,127)

2022 Federal Income Tax Payable - GRE $4,169

Type: ES

Topic: Trusts - comprehensive problem: graduated rate estates (GRE)