



## Tax Changes for Testamentary trusts – More than just the elimination of graduated rates

A bit of background first. In the 2013 Federal Budget the seed was planted. The elimination of graduated rates for testamentary (and certain other) trusts was in the works. (see [2013 Federal Budget Tax Topic](#)). In the summer of 2013, the Department of Finance released a Consultation Paper which outlined its intended approach to the matter which outlined a list of administrative aspects that would be changing along with the rates. (see June 2013 As a Matter of Tax article "[Consultation on the elimination of graduated rates for testamentary trusts](#).") In brief, all testamentary trusts would pay tax at the top marginal rate on every dollar of income retained in the trust after a 36 month period. The paper called for submissions by interested parties by December 2, 2013. Several organizations made submissions – STEP, CBA-CPA Joint Committee, CALU.

The 2014 Federal Budget released on February 11, 2014 provided draft legislative measures that basically would implement the measures as outlined in the Consultation Paper. The only stated deviation was the intention to allow graduated rates to continue for testamentary trusts that benefit disabled individuals eligible for the disability tax credit. (see [2014 Federal Budget Tax Topic](#)). We were awaiting more details.

On August 29, 2014 draft legislation was released containing further details. The further details revealed more will be changing than just the rates and the measures cited in the June 2013 Consultation paper and 2014 Federal Budget materials. It appears that there can be some negative impacts where probate avoidance planning is undertaken using multiple Wills.

Underpinning all of the change is a simple concept. The draft legislation includes a definition for the term "Graduated Rate Estate" (GRE). This definition provides that the GRE of an individual is "the estate" that arose on and as a consequence of the individual's death for no more than 36 months after death and that is a testamentary trust. "The estate" must designate itself as the GRE and no other estate can designate itself as the GRE of the same individual. Sounds simple enough.

A potential problem is that the draft legislation makes changes throughout the Income Tax Act (the "Act") which essentially take any tax benefit that a testamentary trust previously had, and only allows these benefits to be enjoyed by the one and only GRE. If there are two Wills, one dealing with significant probate-able assets (like public company shares, real estate, non-registered mutual fund investments, etc.) and one dealing with assets not being probated (for example shares of a private company), and these Wills appoint different trustees, arguably, only one of those trusts can be "the estate". Only one of those trusts could be considered the GRE.

Now, if the trustees of these trusts were the same, there would be one estate (notwithstanding that there may be two Wills) so this result would not appear to arise. However, it may be more common that a Will dealing with private company shares may have a different trustee than the probated assets because the testator may wish to have a different trustee with different competencies deal with the shares of a business. This may result in the trust in this Will not being considered part of "the estate" of the individual.

So if there are different trustees and, for example, in the probated Will there is a gift of publicly listed securities to a charity, the nil capital gains inclusion rate on the donation of the securities (under paragraph 38(a.1) of the Act) is only available to the GRE and only the GRE could avail itself of the tax benefits of the "50% solution" insured share redemption strategy (using subsections 112(3.2) and 164(6) of the Act). Only one of the above testamentary trusts could be designated as the GRE and allowed to benefit from the relevant tax benefits.

Also, a separate insurance trust created on death with life insurance proceeds could not be viewed as "the estate" whether

the trustee is or is not the same person. Although the trust created is a testamentary trust, it is not part of "the estate" so an insurance trust cannot be a GRE.

The stated deadline for comments is September 29, 2014. Given that this is a budget implementation Bill put forward by a majority government, it may be hard to bring attention to this. Although the problem discussed above may be important to planners and practitioners, it may not be something viewed by the Department of Finance as important enough to resolve. Some combination of CALU, STEP and the CBA-CPA Joint Committee may try to highlight this problem and seek a resolution of it. But, it may well be that planning and Will drafting would just have to take this new aspect into account.

Also, the August 29, 2014 draft legislation contained details of other 2014 Federal budget measures and updated draft legislation relating to the exempt test and policyholder tax rules for life insurance policies. Future As a Matter of Tax articles will deal with these other measures separately.

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