TRUSTS 21 YEARS AFTER

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Trusts 21 Years After

When is 21 Years Up?

Personal Trusts – Intervivos and testamentary	21st anniversary of trust being created and then every 21 years thereafter.
Testamentary spousal or common-law partner trust	Death of beneficiary spouse and then every 21 years thereafter
Alter ego trust	Death of contributor / settlor and then every 21 years thereafter
Joint spousal / common-law partner trust	Death of last surviving spouse and then every 21 years thereafter

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The clock starts ticking 21 years after the trust is constituted, generally being the day on which the three certainties are present and assets are initially settled into the names of the trustee.

For a testamentary trust the trust begins on the day the person dies.

There are a number of exceptions to the 21 year rule as pointed out above.

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Deemed Disposition of Property Under the 21-year Rule

- Most but not all assets are deemed dispose of every 21 years

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Applies to capital property (both depreciable and non-depreciable). These rules do not apply to a very limited list of assets such as inventory that is not land inventory, and depreciable property not included in a prescribed class (pre-1972), and a life insurance policy.

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Property Subject to the 21-year Rule Include:

- Depreciable property (now includes goodwill);
- Non-depreciable capital property;
- Canadian and foreign resources property; and
- Land inventory

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Note that a life insurance policy owned by the trust is not subject to the 21-year rule.

Where the 21-year rule applies, on the specific day, the trust is deemed to have disposed of the particular property at its fair market value and to have reacquired it at the respective fair market value at the date of a deemed disposition. The deemed disposition under the 21-year rule occurs on the day that is 21 years from the creation of the trust, meaning at the end of that day and not the night before. For example, a trust which is created on January 1, 2000, will have a deemed disposition of its assets at the end of the day on January 1, 2021. This is not always the case with respect to other deemed disposition provisions in the Act, which can provide for the disposition and reacquisition to occur at different times in the day.

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Property Subject to the 21-Year Rule

Common properties owned by a trust subject to the 21-year rule include:

- Small business corporation shares
- Farming and fishing property
- Mutual funds, shares, investments
- Real estate, depreciable property
- Personal-use property which gives rise to a gain (not a loss) including principal residence
- Listed personal property which gives rise to a gain (and not a loss)
- Canadian and foreign resource property and land held as inventory

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Reporting Deemed Disposition

- Use form T1055 “Summary of Deemed Realizations
- CRA have been following up for this form diligently
- Trust may elect to pay tax in 10 annual instalments. Form 2223 per ss.159(6.1)
- No deemed year-end for the trust except for alter ego, spouse or joint spouse / common-law partner trusts

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If the deemed disposition rules apply and taxes result, the trust can elect under ss.159(6.1) to pay the tax resulting from a deposition of non-depreciable capital property and land inventory in up to 10 equal annual instalments but interest is charged. This provides some relief of tax burden, however, a trust cannot defer tax arising on a deemed disposition of depreciable property and resource property by making the election.

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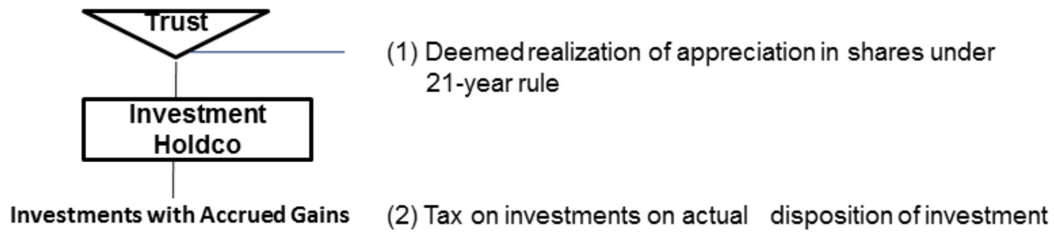
Implications

- Deemed realization of gains
- May result in double taxation where trust owns corporation



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Implications

- Deemed disposition results in gains/losses in trust
    - Capital gains can be allocated to beneficiaries except for alter ego, spousal, joint spousal / common-law partner trusts
    - Capital losses cannot be allocated to its beneficiaries in any circumstances

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Certain capital gains cannot be allocated to its beneficiaries on deemed disposition pursuant to subparagraph 104(6)(b)(i) which prevents the allocation of trust income to beneficiaries attributable to the application of the 21 year rule if income and gains occasioned by:

- the death of the settlor of an alter ego trust
- the death of partner or spouse of a post-1971 spousal or common-law partner trust
- the death of the settlor of a “protective” trust to which paragraph 104(4)(9.4) applies

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Planning

Planning techniques include:

1) Roll-outs before event
2) Reduce the value of the trust assets before event
3) Capital loss carryback
4) Corporate freeze and distribution
5) Vesting of beneficial interest
6) Do Nothing

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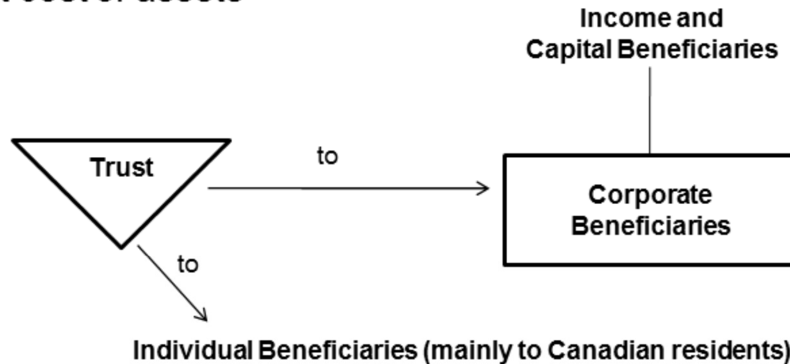
1. Roll-Outs

- tax-free at cost of assets



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Where trust property is distributed to its capital beneficiaries on a tax-deferred basis, the trust is deemed to have disposed of its property at cost and the beneficiaries are deemed to have acquired the same assets at cost deferring tax to both the trust and its beneficiaries until such time as the property is sold. If these assets are subsequently transferred to someone else or the beneficiary has a deemed disposition either as a result of his/her own death or ceasing to be a Canadian resident, then the property is deemed to have disposed of then.

The "rollover" rules do not apply to all distributions. Exceptions include:

- If the trust or the beneficiary elects out of the rollover under 107(2.001) or 107(2.002)
- Property subject to the ss.107(4), such as a distribution by:
  - A spousal trust while a beneficiary spouse is alive to someone other than the spouse,
  - A joint spousal trust while either spouse is alive to someone other than either of the spouses, or
  - An alter ego trust while the settlor is alive to someone other than the settlor
- To a distribution of property subject to ss.107(4.1), generally a distribution from a revocable trust
- To a distribution subject to ss.107(5), namely, a distribution of property to a non-resident beneficiary (with limited exceptions)

In the above situations, the trust is deemed to dispose of the distributed property at its fair market value, resulting in potential taxes to the trust.

An important point is to make sure subsection 75(2) never applied to the trust at any time on any property. Otherwise no rollout.

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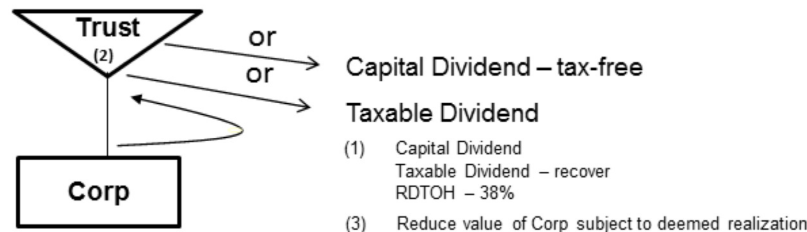
2. Reduce the Value of the Trust Assets

- pay out capital dividend
- pay out taxable dividend if RDTOH is available



(1) Corp can distribute dividends to reduce its value
(2) Trust may retain assets or distribute to beneficiaries
(3) Value of Corp is reduced by amount of dividends declared

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The payment of dividends will reduce the value of the shares owned by the trust and therefore the ultimate tax on the deemed realization. The advantages in this strategy are that the trustees can retain control over the trust assets and even decide to retain the dividend income within the trust, as opposed to distributing income to the beneficiaries, if desired. Also, there are no “even-hand” issues to contend with and such strategy will permit the trustees to continue to administer the trust assets, perhaps for an additional 21-year period.

This strategy very much depends on the figures and the situation.

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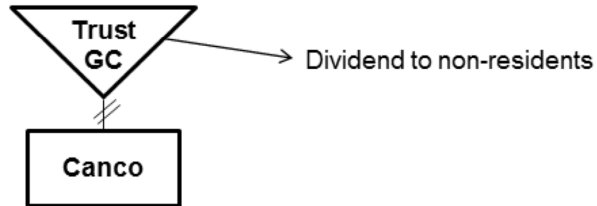
3. Carryback Losses



1) Realize gain in the trust through 21 year application, step up cost base of shares.

2) Redeem **all** shares of Canco – realize capital loss and deemed dividend.

3) Carryback loss to offset gains realized from 21-year deemed realization.

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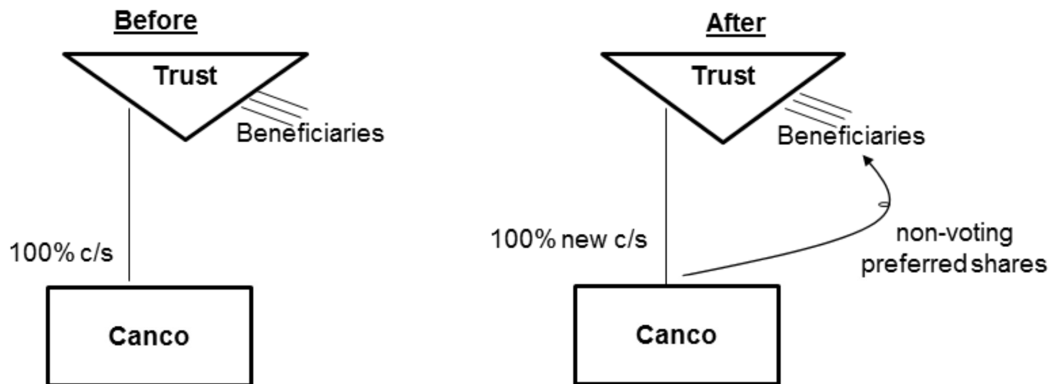
4. Corporate Freeze and Distribution



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In anticipation of the 21-year deemed disposition, the trustees may consider reorganizing the capital of the corporation so that the common shares owned by the trust are exchanged for preferred shares having a fair market value equals to the “old” common shares, and a low adjusted cost base for tax purposes. The preferred shares will be distributed to the capital beneficiaries prior to the 21-year deemed realization thereby avoiding the deemed disposition. A new class of common shares will be issued to the trust or to a new trust which will benefit from the future growth of the corporation. The trustees, in this scenario, can retain control of Canco by the fact that it owns the voting shares in Canco.

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5. Vesting of Beneficial Interest

- If trust deed allows, may vest trust interests in beneficiaries
- Not allowed if non-resident has more than 20% of the trust interest

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6. Do Nothing

- No significant gain to realize
- Have accrued losses that can be triggered to offset the gains
- Realize the gain in private company shares, step-up cost base, carryout pipeline planning.
- Gain is eligible for capital gains exemption and paid out.

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Realizing a gain can sometimes be helpful. It could drive a capital gains strip type transaction.

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