The Private Wealth & Private Client Review

Editor
John Riches

Law Business Research

THE PRIVATE WEALTH & PRIVATE CLIENT REVIEW

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EDITOR'S PREFACE

There are three dominant themes that have emerged in the last year as ones of critical importance for advisers to wealthy families. These themes are the morality of tax planning, the changing relationship between taxpayers and Revenue authorities and expectations for transparency in disclosure of asset holding structures. It is no surprise that these themes are intimately linked.

With regard to the subject of the morality of tax planning, there is clearly a concerted effort being made by governments in OECD jurisdictions to create an ethical climate not only in which tax evasion is reviled as criminal activity (as it rightly should be) but also in which 'aggressive' tax planning is regarded with disdain and stigmatised. It is apparent that politicians and policymakers alike are responding to what is clearly a perceived swing in public opinion that is not unlike that which occurred in the early 1930s. The arguments advanced in favour of encouraging taxpayers to see it as their moral duty (as well as legal obligation) to pay taxes and to refrain from indulging in aggressive avoidance are based on the proposition that the wealthiest members of society should make a proportionate contribution to public services and support those less fortunate than themselves. As a basic proposition this is clearly correct. The debate becomes rather more problematic when complex arguments are reduced to simplistic sound bites especially in the context of a perception of what is regarded as aggressive tax planning – it is notable in the UK in the aftermath of the Spring Budget of 2012, when the government had proposed capping the amount of relief available to taxpayers to a maximum of 25 per cent of an individual's annual income, serious commentators were suggesting that the individuals who made significant contributions to charity and claimed tax relief were in some way engaging in aggressive tax avoidance. This is just a small example of the way in which the rhetoric of debate over tax policy becomes swirled in confusion – frequently, there is a tendency to characterise certain aspects of tax systems that are deliberate reliefs or exemptions as loopholes.

There is also some irony in the fact that this proposal was withdrawn in response to a concerted campaign from the voluntary sector – an argument that could have been advanced in defence of the proposal was that allowing unlimited tax deductions for charitable donations might be seen as a form of hypothecation in which individuals with sufficient funds could substitute donations to their favoured charities for contributions to the basic services which other taxpayers effectively support. This reasonable defence of the proposal was somewhat lost in the furore and never effectively advanced.

One especially concerning aspect of the debate about the morality of tax planning is the absence of any parallel emphasis upon the duty of tax authorities to produce clear and fair rules of taxation that could be easily understood and applied – if one sees the relationship between taxpayer and tax authority as akin to a 'social contract' then there has been rather too little emphasis upon the duties of tax authorities to refrain from ill-thought out changes to tax statutes or from producing sweeping anti-avoidance rules that create huge uncertainty for both individuals and businesses.

Regardless of this, it would seem that in the years ahead, those of us acting as advisers to wealthy families will need to ensure that in delivering our advice on what is an appropriate tax strategy to our clients, we bear in mind the possibility that, in future, the actions of our clients (and indeed our own advice) are likely to be judged not just for their technical accuracy, as is legally appropriate, but also for their 'moral' content. In the prevailing climate, it will be important for us to highlight for clients whether the tax planning strategy being considered may risk being seen as unduly aggressive even if it is legally correct.

One positive development in the area of relationships between Revenue authorities and wealthy taxpayers is the introduction of high net worth ('HNW') units in many OECD countries. These units look to provide a greater degree of coordination in overseeing the usually more complex tax affairs of wealthy individuals and the ability for a taxpayer's professional adviser (in some cases) to foster an enhanced relationship of openness with the HNW unit – given that in many jurisdictions the principle of self-assessment places an onus upon taxpayers to highlight areas of uncertainty so that the Revenue authority can consider them. It could well be the case in future that those taxpayers will find their long-term interests are better served by erring on the side of transparency in their dealings with Revenue authorities. In many jurisdictions, the ability to seek advance rulings is one route to achieving greater certainty; in others, ensuring one's tax adviser has well-placed contacts with Revenue authorities is an alternative. The traditional climate of mutual suspicion that has historically been characteristic of dealings between taxpayers and tax authorities will not evaporate overnight. The evidence emerging in other sectors (notably that of large corporate taxpayers) is, however, that in many cases, a more transparent approach will serve the client's interests and also may reduce compliance costs. This is not to suggest that the role of the tax adviser should not be to defend and advance the client's interests robustly on specific tax issues but to suggest that advisers also consider how to achieve an optimal outcome bearing in mind that it is in the client's long-term best interests to remain in good standing with the tax authorities.

Moving to my final and third theme, the publication by the OECD in February 2012 of its updated guidance in respect of the FATF 40 recommendations and the expanded interpretive notes accompanying them[1] are the latest manifestation at the supranational level of policymakers seeking to force through a transparency agenda for international holding structures in their fight against tax evasion. I set out below some comments from interpretive guidance on Recommendation 24 commenting on bearer share arrangements.

1 See www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%20approved%20February%202012%20reprint%20March%202012.pdf – see in particular pp. 82–87 with interpretive notes on recommendations 23 and 24.

14. Countries should take measures to prevent the ***misuse of bearer shares and bearer share warrants,***[2] *for example by applying one or more of the following mechanisms: (a) prohibiting them; (b) converting them into registered shares or share warrants (for example through dematerialisation); (c) immobilising them by requiring them to be held with a regulated financial institution or professional intermediary; or (d) requiring shareholders with a controlling interest to notify the company, and the company to record their identity.*
15. Countries should take measures to prevent the misuse of nominee shares and nominee directors, for example by applying one or more of the following mechanisms: (a) requiring nominee shareholders and directors to disclose the identity of their nominator to the company and to any relevant registry, and for this information to be included in the relevant register; or (b) requiring nominee shareholders and directors to be licensed, for their nominee status to be recorded in company registries, and for them to maintain information identifying their nominator, and make this information available to the competent authorities upon request.

It will be seen from this that the underlying philosophy to the FATF guidance is that any arrangement that is based upon anonymity will be regarded by authorities as suspicious and a prima facie indication of an attempt to conceal the reality of beneficial ownership. In the vast majority of cases, families wish to maintain privacy in relation to their financial affairs not to evade taxes, but to maintain anonymity to protect their assets from predators such as kidnappers or individuals who may be motivated to exploit them in inappropriate ways. The fact that the FATF's mandate was renewed in April 2012 for a further eight years until at least 2020 is evidence of the desire of OECD countries to maintain a sharp focus on transparency in tandem with the actions of the parallel initiatives being undertaken by the Global Tax Forum.

It is quite clear that the boundary line as to what can legitimately be regarded as private and not requiring explanation or justification in the structuring of an individual's financial affairs has been radically redrawn in recent years. Any individual wishing to engage the services of a financial institution or professional adviser will be effectively obliged to provide full beneficial ownership information as an essential pre-condition. As advisers we will therefore need to carefully consider the way in which we can legitimately protect our law-abiding taxpaying clients from unwarranted and unwelcome scrutiny from those who are motivated by greed or improper motives. We also need to ensure that we maintain an effective and ongoing dialogue with policymakers that highlights the legitimate strategies that wealthy families pursue and the many non-tax reasons that underpin those strategies – in particular, where complex cross-border challenges of holding assets are addressed by using trusts or foundations that have a strong rationale in ensuring business continuity or legitimate asset protection.

To conclude, in the years ahead I believe it may well behove us, as advisers, to exercise proper judgement to assist our clients in making appropriate choices with regard to the moral probity as well as the legality of their tax planning arrangements. Equally, it will be necessary to consider very carefully how to properly protect our clients' privacy without giving the impression that their desire for privacy is a cloak for other

2 Emphasis added.

improper motives that will invite unwelcome suspicion or hostility from tax or regulatory authorities or indeed third-party service providers with whom they wish to engage in a business relationship. Failure to abide by the new prevailing norms of transparency could well be costly. The effectiveness of our own advice in the future is likely to be judged with the benefit of '20/20' hindsight. I commend this review to you and hope you find it a helpful resource in advising your clients.

John Riches
Withers LLP
London
July 2012

Chapter 8

CANADA

Margaret R O'Sullivan and Claudia A Sgro[1]

I INTRODUCTION

i Canadian wealth on the rise

Since the onset of the 2008 global financial crisis, Canada has emerged as one of the few Western-developed economies that has weathered the economic storm successfully and without the severe dislocation other countries have experienced. It has arguably emerged stronger and more internationally competitive than before, and is increasingly regarded as one of the few 'safe havens' in a very financially and politically troubled world. Underpinning this evolution is the stability of the Canadian banking system, which has distinguished itself as a model for others to emulate with its conservative lending practices, strong capitalisation requirements and effective regulatory oversight. Because of their strong balance sheets, Canada's six largest banks have catapulted to the top of the heap. The major banks of this small nation of approximately 35 million are now in the ranks of the world's ten strongest banks and three of them are in the world's 30 largest banks by assets. As well, Canadian insurance companies rank among the world's largest insurers, three of them in the top ten by assets.

As a result, Canada is an increasing beacon for high net worth individuals for investment and immigration, as an attractive place both to live and to invest. Apart from a solid economy, stable financial and banking system, good government, and a strong currency, Canada also boasts one of the highest standards of living and highest qualities of life in the world. Canada ranks eighth in the world in terms of aggregate household wealth, and thirteenth in wealth per adult. In terms of concentration of wealth, Canada has over a million millionaires and comprises 4 per cent of the world's top 1 per cent most wealthy individuals although it has only 0.5 per cent of the world's population.[2] The bottom line: Canadian wealth and Canada's ranking as a favoured nation for investment is on the rise.

1 Margaret R O'Sullivan and Claudia A Sgro are lawyers at O'Sullivan Estate Lawyers Professional Corporation.

2 See *Global Wealth Report 2011*, *Credit Suisse*, October 2011.

ii Key factors in respect of private clients

Canada's constitutional system is a federal one, with a clear division of powers between different levels of government. Its primary legal heritage for all provinces and territories, with the exception of Quebec, is based on English common law; Quebec's is based on civil law. From the private client perspective, Canada offers the stability of a highly developed legal and court system and charter-based human rights protections. Property law, including succession, is a matter of provincial jurisdiction. Many modern and innovative concepts affecting private clients have been pioneered or progressed ahead of other jurisdictions in Canadian law, including equalisation of property between spouses on marital breakdown and death in several Canadian provinces recognising marriage as an equal economic partnership, recognition of common law spouses' and same-sex spouses' property and support rights, and same-sex marriage. Many Canadian jurisdictions have modern laws governing incapacity and substitute decision-making to take into account the need for a modern infrastructure to deal with an increasingly ageing population. Canada's multiculturalism and relatively 'open door' immigration policy which is required to maintain positive population growth and expand the Canadian economy and is increasingly geared to attracting more entrepreneurs and skilled workers have together created and contributed to a dynamic, sophisticated, diverse and innovative Canadian culture.

II TAX

i Personal taxation

Federal and provincial income tax

Canada taxes Canadian residents on their worldwide income from all sources, and non-residents on certain Canadian-source income, subject to international tax treaties. Income for Canadian tax purposes includes income from employment, business, property, 50 per cent of capital gains, and various other income sources, less certain deductions.

Canada is a federal state consisting of ten provinces and three territories. The provinces and territories also tax income generally on the same basis as the federal government, except for Quebec, and increased federal tax applies to certain income not earned in a province. Canadian tax is levied at graduated rates of up to approximately 46 per cent in combined federal and provincial rates on taxable income above C$132,000 in a taxation year, less applicable tax credits. Surtaxes of a province can result in elevated effective tax rates. In Ontario, an effective combined rate of nearly 48 per cent now applies commencing in 2012 to taxable income over approximately C$500,000 in a taxation year.

Canada taxes non-residents on income earned in Canada, notably income from business or employment in Canada and from certain taxable Canadian property, including Canadian real estate. A withholding tax of 25 per cent is deducted from certain income relating to non-residents, subject to international tax treaties which reduce the applicable rates.

No gift or inheritance taxes – capital gains regime

Unlike most jurisdictions, Canada has no gift or inheritance tax. Instead, Canada introduced capital gains tax in 1972, recommended by the report of the Royal Commission on Taxation ('the Carter Commission Report'), which aimed to create a comprehensive tax base to fund social programmes. The Carter Commission Report recommended the taxation of net capital gains on property, the inclusion of gifts and inheritances in income, and the repeal of the federal wealth tax. As a political concession, ultimately only 50 per cent of capital gains were included in income for tax purposes. Federal gift and estate taxes were discontinued in 1971, and by 1985 no province levied a wealth transfer tax. In 2012, 50 per cent of capital gains are included in income upon actual disposition or deemed disposition. There is an exemption for capital gains on a principal residence and a lifetime exemption (C$750,000) for capital gains on certain qualified business-use property.

The basic tax unit is the individual. Limited opportunities exist for income splitting, including by the use of trusts, which are taxed as individuals subject to additional rules. Tax on capital gains may be deferred on certain transfers of property, for example, between spouses.

ii Developments relating to personal taxation

Ontario's new high income tax bracket

Personal tax rates remained constant for much of Canada in 2012. Ontario has introduced a temporary new tax bracket for taxable income over approximately C$500,000, which will result in a combined federal and provincial rate of approximately 50 per cent in 2013 as a temporary measure designed to decrease Ontario's deficit and balance its provincial budget by 2017–2018.

Residence of trusts for tax purposes

The Supreme Court of Canada in 2012 clarified the law on the tax residence of a trust. In *Fundy Settlement v. Canada* (2012), also known as *Garron Family Trust* and *St Michael's Trust Corp.*, trusts had been established to hold growth shares in a Canadian corporation, with a Barbados-resident corporation as trustee, a settlor who was a non-resident of Canada, and beneficiaries who were Canadian residents. The trustee claimed the return of over C$150 million in withheld amounts on the sale of the shares on the basis that the trusts were resident in Barbados. The Canada Revenue Agency ('CRA') took the position the trusts were Canadian resident.

The Supreme Court of Canada held that the residence of a trust is where the central management and control of the trust occurs, applying a test rooted in corporate law, and a significant change from the former focus on a trustee's residence. A trust's residence will be that of the trustee only if the trustee exercises its central management and control where he or she is resident. On the facts, it was held that the trusts were Canadian resident as the central management and control had been exercised in Canada by the main beneficiaries, and St Michael had played a limited administrative role. After *Fundy Settlement*, tax planners can no longer rely on the presence of offshore trustees to determine a trust's tax residency, and should instead consider where the central management and control of the trust will be exercised.

Application of the general anti-avoidance rule respecting income tax

There is increasing concern over the application of the general anti-avoidance rule ('GAAR') in the Income Tax Act (Canada), on which there has been little case law to date. In late 2011, the Supreme Court of Canada in *Copthorne Holdings Ltd v. Canada* upheld the rulings of the Tax Court of Canada and Federal Court of Canada and confirmed that 'contemplation' under the GAAR could operate retrospectively. A parent corporation and its subsidiary had been combined using more than one step to create a resulting corporation rather than directly amalgamated with one another, effectively preserving the paid-up capital (similar to stated capital for tax purposes) of the subsidiary in the resulting corporation rather than cancelling it as would occur in a direct amalgamation with one another. Shares of the resulting corporation were redeemed and amounts attributed to paid-up capital were treated as a non-taxable return of capital to a shareholder which was a non-resident of Canada. The plan could have resulted in tax savings of approximately C$58 million if not struck down by the court.

The court applied the standard test for the GAAR: whether there was a tax benefit, whether the transaction giving rise to the tax benefit was an 'avoidance transaction' (or series of transactions) and whether the avoidance transaction giving rise to the tax benefit was abusive. It found that there was a clear tax benefit and the transactions did not have a primary non-tax purpose. With respect to the avoidance transaction or series of transactions, *Copthorne* confirms that the GAAR can include in a series of transactions 'any related transactions or events completed in contemplation of the series' whether these were 'contemplated' prospectively or retrospectively. The court noted that provisions in the Income Tax Act (Canada) relating to paid-up capital demonstrated a policy against surplus stripping.

Also in 2011, three lower-court cases (*Triad Gestco, 1207192 Ontario Ltd* and *Global Equity Fund Ltd*) found different outcomes when applying the GAAR to somewhat similar facts. Losses were claimed when shares of newly incorporated companies which had declared dividends were subsequently sold to family trusts. The Tax Court applied the GAAR in *Triad Gestco*, as there was an avoidance transaction with no real economic loss. In *1207192 Ontario Ltd*, the GAAR was not applied as there was a creditor-proofing motivation for the transaction. At the time of writing, all three cases are on appeal to the Federal Court of Appeal (scheduled to be heard on dates in September and October 2012).

High net worth audit initiatives

As in other jurisdictions, the CRA is increasingly singling out high net worth individuals for audit. In its Related Party Initiative, individuals including high net worth individuals (over C$50 million) or those with complex planning using related entities have been asked to provide detailed information and supporting documents about Canadian and foreign interests. In its domestic trust audit project, CRA has also focused on the use of trusts more generally including trusts with interprovincial aspects as well as whether they have been correctly established and administered from a legal and tax perspective. There has also been proposed an Aggressive Tax Planning Reporting Regime, which would require advisers to report to CRA information concerning certain transactions.

iii Cross-border structuring

Tax advantages on immigration to Canada

Canada relies heavily on immigration and offers certain tax concessions to immigrants. These same concessions along with the lack of gift and inheritance tax make Canada an attractive destination. Upon immigration to Canada, an individual receives a 'step-up' in the tax cost of his or her capital property (excluding taxable Canadian property) which eliminates Canadian tax liability for capital gains accrued to that point.

Taxation of non-resident trusts and immigration trusts

Certain non-resident trusts established by non-resident settlors provided certain conditions are met, are exempt from tax and can distribute trust capital to Canadian resident beneficiaries tax-free, resulting in various tax planning opportunities both *inter vivos* and on death of the non-resident settlor or testator. For example, a non-resident inheritance trust under a non-resident's will sited in a low-tax jurisdiction may be established to minimise taxation of inherited assets where there are Canadian resident beneficiaries.

An immigration trust can be set up to benefit an immigrant to Canada and his or her family under certain conditions. The income and capital gains in the immigration trust can accrue tax-free for up to 60 months, and if the trust is settled in a foreign jurisdiction (including a low-tax offshore jurisdiction) with foreign trustees who hold the foreign investment assets there can be significant tax savings depending on comparative tax rates.

Taxation on emigration from Canada

A taxpayer emigrating from Canada must pay a departure tax which taxes gains on his or her property which accrued during his or her Canadian residency, subject to exceptions including for certain Canadian *situs* property and retirement plans. Payment of the departure tax may be deferred upon providing security to the CRA in like amount.

Tax treaties

Canada is a party to many favourable tax treaties which in part aim to prevent double taxation of income. However, due to variations in the internal taxation law of treaty nations, there can be mismatches in tax credits and timing which are not addressed in the treaties. Among other benefits, Canada's tax treaties include tiebreaker rules relating to tax residency for treaty purposes, and reduce the amount of withholding tax required from income relating to non-residents (often to 15 per cent from 25 per cent and in certain cases to 0 per cent).

Foreign investment entity and foreign trust rules

In the 1999 federal budget there were proposed foreign investment entity rules and foreign trust rules designed to more effectively tax Canadian residents' passive investment in a broad array of non-resident entities such as trusts, corporations and mutual funds. The proposed rules were heavily criticised as unworkable and were amended on several occasions over a protracted period, being significantly scaled back in the 2010 federal budget and 2010 draft legislation, not yet in force. However, certain underlying issues relating to taxation of foreign investment income remain unresolved. In addition, proposed changes to the non-resident trust rules if and when in force may deem a trust Canadian-resident based on the presence of a Canadian-resident contributor, broadly defined, and would also require tax to be withheld on distributions from a trust deemed Canadian-resident, subject to exceptions.

iv Regulatory issues

Regulation of banking and related industries

A significant portion of Canada's private wealth services are highly concentrated in the hands of six major Canadian national banks. In 2011, Bloomberg Markets Magazine ranked four Canadian banks (Canadian Imperial Bank of Commerce, Toronto-Dominion Bank, National Bank of Canada and Royal Bank of Canada) among the world's top ten strongest banks with US$100 billion or more of assets. Banking is federally regulated by the Office of the Superintendent of Financial Institutions Canada, while the related investment industry, trust companies and insurance firms are regulated both federally and provincially. Canada's major banks are strongly capitalised, and tend to have conservative lending policies relative to other banking institutions.

Starting in 1986, the federal government eliminated the four pillars of Canadian finance, Canada's traditional regulatory separation between banks, trust companies, insurance companies and investment companies. Numerous acquisitions of investment firms and trust companies by the six largest Canadian banks followed. In 1998, the proposed merger of two of the largest major Canadian banks was rejected by the federal government. In the past decade, Canada's major banks have expanded significantly into the United States. Canada's major banks offer an increasing array of services including daily banking, investment services, financial planning, insurance and wealth management, which tend to be fairly uniform among the banks.

Canadian insurance companies are also overrepresented in the world's ten largest insurance companies, where three Canadian insurance companies rank. Deregulation resulted in a flurry of mergers and acquisitions in the 1990s leading to consolidation and the three largest insurance companies controlling about two-thirds of the domestic market.

v Issues affecting holders of active business interests

Corporate taxation

Canada's favourable business environment includes low corporate taxes levied at flat rates which have been reduced aggressively in the past five years. For active businesses, combined net federal and provincial corporate tax rates range between 25 per cent and 31 per cent, and a similar rate applies to income not earned in a province.

Preferred tax treatment is offered to a 'small business corporation', a defined term, which receives typical combined federal rates between 11 per cent to 15 per cent in the provinces, except Quebec, on the first C$500,000 of active business income. A small business corporation includes a Canadian-controlled private corporation with capital under C$10 million carrying on active businesses in Canada. Shares of a small business corporation are eligible for a lifetime capital gains exemption of C$750,000 in total, as are certain qualified farm and fishing properties.

Investment income earned in a corporation is taxed at approximately the highest personal income tax rate (46 to 51 per cent in the various provinces) and at lower rates for income earned in small business corporations. A gross-up and dividend tax credit mechanism is designed to avoid double taxation of dividends earned in a corporation which are subsequently paid to an individual.

A tax-deferred transfer or roll-over of certain eligible property to a taxable Canadian corporation for consideration, including shares, is available subject to conditions. The property may retain its tax cost or receive a higher tax cost within limits. Among other results, the corporation assumes tax liability relating to gains in the property, payment of which is deferred to a later date.

Goods and services tax or harmonised sales tax

Canada levies a 5 per cent supply-side tax on most services and goods, including those made in Canada and imported, and certain property. The goods and services tax applies at all stages of production, subject to an input tax credit for tax paid at an earlier stage, and businesses are responsible for collecting and remitting the tax. In five provinces, the tax has been harmonised with the provincial sales tax and is known as harmonised sales tax, with combined rates between 12 and 15 per cent.

III SUCCESSION

i Overview of succession in Canada

Provincial and territorial jurisdiction

In Canada, succession to property on death is a matter within the jurisdiction of the provinces and territories. Of Canada's ten provinces and three territories, 12 are governed under the common law, and one, the province of Quebec, under the civil law.

Conflicts of laws

With regard to determining the applicable law, the law governing succession to moveables is generally that of the testator's domicile and the law governing succession to immoveables typically the jurisdiction where the property is located. Formal validity, which includes such matters as execution requirements for a will, is determined by conflicts of laws principles (and in respect of succession to moveables is also generally that of the testator's domicile at date of death and in respect of succession to immoveables is typically the jurisdiction where the property is located), and in several provinces has been expanded by statute.

Probate or equivalent court process

The common law principle of testamentary freedom is the general rule in Canadian succession law, as modified by contract or legislation. After the testator's death, a will is typically submitted to probate or equivalent court process, whereby it is validated and the executors' appointment as legal representatives confirmed. In this process, the will and supporting documents, which may include a detailed asset listing, become public. Probate fees are typically levied in the form of a flat fee, or tax based on a percentage of estate assets (e.g., approximately 1.5 per cent in Ontario). In some provinces, in particular those with a high rate structure to probate a will, the option of creating a second, non-probate will which governs private company shares and other assets which do not require a court grant of probate to administer is often used to minimise probate fees and tax. A Quebec notarial will need not be submitted to probate in that province.

Legislative provisions for succession on intestacy

On an intestacy, each province and territory provides for a scheme of property division: typically between the testator's surviving spouse and children, if any, failing which to other relatives as specified. Some provinces allot the spouse a preferential share prior to dividing the estate between spouse and children. In this context, spouses are married spouses including same-sex married spouses and in some provinces and the territories also *de facto* spouses providing certain conditions are met. A court process for letters of administration or equivalent provides for the appointment of estate trustees on intestacy.

Legislative provisions for dependant's support

In all provinces, a dependant can claim support from the deceased's estate, provided he or she stands in a certain relationship with the deceased (typically including a spouse, *de facto* spouse or minor child) and the deceased was providing him or her with support or had a support obligation at the time of death. The quantum of support is determined circumstantially and with judicial discretion, usually taking into account needs and means. Some provinces recognise a moral entitlement to share in a deceased's estate and will vary the distribution in a will or award support on this basis.

Legislative provisions for matrimonial property rights on death

The matrimonial property regimes of several provinces provide the surviving spouse with property rights on a first spouse's death. For example, in Ontario, a surviving spouse has a right to elect to claim against the deceased spouse's estate to notionally equalise the property acquired during marriage as between the two of them. If such an equalisation claim is made, she or he thereby loses entitlements, if any, under the deceased spouse's will and to certain other benefits.

ii Key legislative or case law changes affecting succession

Alberta's new Wills and Succession Act

Two Western provinces, Alberta and British Columbia, recently updated their succession law statutes. Alberta's Wills and Succession Act modernises succession law in that province and consolidates and harmonises the operation of five statutes. Highlights include that a court may rectify a will or purported will by adding or deleting text and may admit extrinsic evidence for will interpretation. On intestacy, if the deceased's descendants are also those of the surviving spouse, all the deceased's estate will go to the spouse. Children who are full-time students aged 18 to 22, and minor grandchildren, may be family members eligible for support. The testator's marriage or signing an adult interdependent partnership agreement does not revoke a will; however, a gift in a will to a separated spouse may be invalid. Survivorship rules are modernised and certain common-law presumptions abolished.

British Columbia's consolidated Wills, Estates and Succession Act

British Columbia's Wills, Estates and Succession Act, not yet in force, would update and consolidate that province's succession law. It includes as a spouse a *de facto* spouse who has cohabited with the deceased for two years. Property division on intestacy is updated including in respect of the share to the surviving spouse. The act modernises survivorship rules and adds a five-day survival provision failing which certain deeming provisions apply. It permits the court to cure deficiencies in and rectify wills. Under the Act, a will is not presumed to be revoked by marriage or a change in circumstances. The Act provides a reverse onus for allegations of undue influence in certain circumstances, and new procedures apply to the administration of small estates under C$50,000.

Ontario to require detailed asset disclosure to probate a will and increased compliance measures to be implemented.

In Ontario, new sections of the Estate Administration Tax Act will require a detailed list of assets and their values on probate or equivalent as of January 2013, and other tax enforcement measures including penalties will now apply. Nova Scotia has raised its probate fees to approximately 1.5 per cent on a large estate, an increase of over 30 per cent since 2000 on a C$5 million estate and significantly greater than equivalent fees in other Atlantic provinces.

iii Cross-border developments

Changes to United States transfer tax

Canada is home to many dual citizens including US–Canadian citizens and many Canadians own vacation property in the United States or other US real or personal property, or spend significant time in the United States. A number of Canadians are, as a result, subject to the US transfer tax regime and attentive to any changes in it. Currently, the US exemption from federal transfer taxes including estate, gift and generation-skipping transfer tax is scheduled to be lowered from its value of approximately US$5 million for 2012 to US$1 million for 2013, and the maximum rate is scheduled to move from 35 per cent to 55 per cent, unless Congress makes legislative changes.

New income tax related reporting requirements for United States persons

A self-reporting scheme applies to US persons (including US citizens, green card holders and certain persons who spend a substantial amount of time in the US) in Canada and elsewhere which may require reporting of non-US bank and financial accounts on a Report of Foreign Bank and Financial Accounts ('FBAR') and detailed reporting of certain non-US financial assets exceeding threshold values on a Statement of Specified Foreign Financial Assets (Form 8938).

The US Foreign Tax Account Compliance Act ('FATCA') sets out reporting and withholding requirements for non-US financial institutions effective 1 January 2014 with respect to accounts beneficially owned by US persons. Non-US entities will also be required to report the ownership or beneficial interests of US persons. With respect to reporting requirements of Canadian financial institutions, FATCA has not yet been implemented in Canadian legislation and the prospect of such implementation has drawn a strong negative response. Concerns expressed by Canadian associations, corporations and individuals include institutional compliance costs, privacy issues, and mismatches in tax liability arising from the difference between the nations' tax legislation.

Relief against certain United States income tax penalties for Canadian residents

The Canadian government has expressed its concern to the US authorities and certain concessions have been granted to Canadian residents who are dual citizens of Canada and the United States. As of June 2012, the US Internal Revenue Service will provide measures to assist such persons to fulfil their filing and reporting obligations. For example, certain taxpayers who present a low compliance risk and who owe $1,500 or less for each of the relevant taxation years will be permitted to file returns and reports without certain penalties or enforcement actions.

iv Applicable changes affecting personal property

Same-sex marriage and Quebec civil unions

In 2005, Canada legalised same-sex marriage and, as a result, a broad array of statutory and common law rights are now available to same-sex married spouses, including rights to share in an estate upon intestacy and any rights to property division under provincial family law statutes. Quebec also solemnises a civil union for same-sex or opposite-sex couples which confers similar rights to marriage.

Rights of de facto spouses

For unmarried *de facto* spouses Canada recognises a limited subset of legal rights. *De facto* spouses are treated similarly to married spouses for various purposes, including taxation and certain government benefits, but significant gaps remain in respect of property rights on relationship breakdown and death, although this varies by province.

Spousal support provisions for de facto spouses

The law applicable to *de facto* spouses may soon see changes. The province of Quebec has a greater percentage of *de facto* spouses than other provinces (approximately 35 per cent in 2006) and there are few legal rights provided to these spouses on relationship breakdown. The case *Droit de la famille-102866*, also known as *Lola v. Eric*, awaits a ruling from the Supreme Court of Canada. Lola (not her real name) claimed spousal support and property rights from her billionaire *de facto* spouse Eric. The Quebec Court of Appeal found that Article 585 of the Quebec Civil Code, which does not provide spousal support for *de facto* spouses although it provides for support among married or civil union spouses, was unconstitutional on equality grounds.

Common law property division for de facto spouses clarified

In *Kerr v. Baranow* and *Vanasse v. Seguin* (2011), the Supreme Court reviewed the principles of unjust enrichment and resulting trust applicable to *de facto* spouses on relationship breakdown. After a relationship of over 25 years, Ms Kerr claimed property and support entitlements. Both parties had worked and Mr Baranow had cared for Ms Kerr after she had suffered a stroke. The court reviewed the law of unjust enrichment applicable to *de facto* spouses not included in most provincial statutory property division schemes. The elements of the claim are enrichment of one spouse, the corresponding deprivation of another, and absence of juristic reason (such as a contract), and remedies have included a constructive trust and monetary amounts, including amounts relating to value received. Where appropriate, the claimant should be treated as a co-venturer in a joint family venture and should share the couple's mutual gains. Indicia of a joint family venture include mutual effort, economic integration, intention and priority to the family, and there must also be a link between the contribution and wealth accumulated. A new trial was ordered in *Kerr* regarding unjust enrichment. A monetary remedy is not limited to a value-received approach, and in *Vanasse*, the Supreme Court upheld a monetary award granted at trial to a partner who had cared for a young family and given up career opportunities during a 12-year relationship.

Spousal entitlement to matrimonial property on death may come to Alberta

Changes amending Alberta's Matrimonial Property Act, which are not yet in force, would permit a surviving spouse who has remained married to claim an entitlement to matrimonial property as against the estate of the first spouse to die.

Legal presumptions relating to jointly held personal property clarified

In two companion cases, *Pecore v. Pecore* and *Madsen Estate v. Saylor* (2007), the Supreme Court of Canada clarified the common-law presumptions of resulting trust and advancement, which are legal presumptions subject to being rebutted on the civil standard of proof. The court clarified that a recipient of gratuitously transferred personal property is generally presumed to hold it on resulting trust for the donor. The presumption that the property so transferred is advanced to the donee which has historically applied to certain family relationships, now applies only to transfers between a parent and minor child (not from husband to wife or from parent to adult child). The court also canvassed issues of evidence. In *Pecore*, the court found that a father who had placed financial accounts into joint names with his daughter had an actual intention to gift these, whereas in *Madsen* the opposite result prevailed.

IV WEALTH STRUCTURING AND REGULATION

i Common vehicles for wealth structuring

The uses of trusts and holding companies are perhaps two of the most common vehicles used in wealth structuring.

Trusts

Income splitting

Trusts can be established *inter vivos* or by will. *Inter vivos* trusts are often used to split income between family members who have lower tax rates, where the trust earns income and acts as a conduit to allocate income, including taxable capital gains, among lower rate taxpayers. Effective planning involves careful attention to the possible application of the attribution rules which can attribute income back to a high tax rate taxpayer.

Trusts used in conjunction with an 'estate freeze'
Trusts are also commonly used in conjunction with an estate freeze to hold growth property, such as common shares of a private holding company, which reflect the future growth of appreciating assets in order to defer taxation of capital gains to the next generation, as opposed to on death of a founder, thereby achieving significant tax savings. Use of a trust can allow for control of the timing of distribution of property and selection of beneficiaries, and for general wealth protection purposes, and a fully discretionary trust is often used for such purpose.

Trusts as will substitutes
Trusts are also increasingly used as will substitutes, in particular 'alter ego' and 'joint partner' trusts which are specifically defined under Canadian income tax legislation and allow persons aged 65 and older, provided certain conditions are met, to roll over capital property on a tax-deferred basis, as opposed to triggering capital gains. The alter ego and joint partner trusts are often used to provide for primary succession to property on death as a substitute to a will. They offer several perceived benefits, including (1) avoiding expensive court fees and tax paid to probate a will, as well as the attendant court process which can be protracted; (2) more privacy than a will; (3) ensuring capital succession to property on death; (4) protection against estate litigation, including will challenges and other claims arising on death, and they are also an effective and sophisticated vehicle to manage assets on incapacity in contrast to a power of attorney.

Use of testamentary trusts for income splitting and other benefits
Testamentary trusts, that is those created by will, are increasingly used to provide for income splitting on death. Unlike *inter vivos* trusts which are subject to the top marginal rate of tax, a testamentary trust is considered a taxpayer under income tax legislation and has graduated rates of tax, like any other individual taxpayer. Use of one or more testamentary trusts under a will can allow for income splitting between the trust and one or more beneficiaries resulting in significant tax savings. Also, use of a testamentary trust provides for probate fee minimisation, capital succession planning and can safeguard against beneficiaries' matrimonial and possible creditor claims, among other benefits.

Multiple wills used to minimise probate fees
Multiple wills are increasingly used in certain provinces to minimise estate administration tax and probate fees. For example, in Ontario, estate administration tax is approximately 1.5 per cent of the value of estate assets. Assets are often segregated under two wills: a primary will and a secondary will. Assets which generally do not require a probated will to administer by way of proof of executors' authority to third parties, such as financial institutions and others, are segregated under a secondary will, including private company shares, family loans, tangible personal property, and beneficial trust interests. Only the primary will is typically probated, and applicable tax or court fees are then based on a more modest asset base.

Holding companies
Holding companies are a common feature of Canadian estate planning. They are commonly used to hold US securities and certain other US *situs* assets to protect against

exposure to US estate tax, to defer tax on active business income where shares of an active business are held by the holding company, to split income, including in conjunction with use of a family trust, and for asset protection and retirement planning.

Potential tax advantages of holding companies

The utility of an investment holding company to earn investment income at a lower tax rate than if earned personally will depend on changing tax rates which historically have at certain times offered tax advantages and at other times are neutral and less advantageous.

Holding companies are also used in conjunction with probate fee and estate tax minimisation strategies as outlined above. Private company shares can pass under a secondary will, which typically may not need to be probated, thereby saving fees and tax which can be significant where the shares have a high value. There is potential for double taxation on death where assets are held in a holding company, since a deceased person will be subject to personal taxation on the deemed disposition of the shares of the holding company giving rise to possible taxable capital gains, and as well the same gains may be reflected in the holding companies' underlying assets, on which tax will be paid at the corporate level on sale of the assets or wind-up of the company. It is therefore necessary to implement proper post-mortem tax planning to avoid potential double taxation on death.

ii Anti-money laundering regime

Federal Proceeds of Crime (Money Laundering) and Terrorist Financing Act

The federal Proceeds of Crime (Money Laundering) and Terrorist Financing Act came into effect in 2001. It introduced requirements for a compliance regime, record keeping, client identification and reporting. Reporting entities must implement a compliance regime, keep certain records, obtain certain client identification, and report suspicious transactions to an independent agency, the Financial Transactions and Report Analysis Centre of Canada ('FINTRAC'). Certain other financial transactions, as well as terrorist property must also be reported. Reporting entities include financial institutions, such as banks, trust companies, loan companies, life insurance companies, brokers and agents, securities dealers, accountants and accounting firms carrying out certain transactions, real estate brokers, and certain others. The legislation imposes harsh financial and criminal penalties, including imprisonment for failure to report. Reporting entities have to send large cash transaction reports to FINTRAC when they receive an amount of C$10,000 or more in cash in the course of a single transaction and financial entities, money service businesses and casinos have to report incoming and outgoing international electronic funds transfers of C$10,000 or more in a single transaction.

V CONCLUSIONS AND OUTLOOK

In general, the last few years seem to be a comparative good news story for both domestic Canadian private clients and international private clients with Canadian interests. Foreign money is increasingly flooding into Canada in unprecedented amounts, and in the midst of global turmoil Canada is, at least for now, one of the few favoured creditworthy nations for investment on an increasingly short list – Australia, Norway and Sweden are others considered safe havens.

However, there are storm clouds gathering, which do not portend a rosy future. Federal and provincial tax authorities are increasingly focusing on high net worth individuals, trusts, probate taxes, and abusive and aggressive tax arrangements, including offshore and interprovincially, to ensure the Canadian tax system and base is not compromised in the face of strained government budgets, increasing deficits, generalised global uncertainty and an ageing baby-boomer population, resulting in fewer tax planning opportunities, greater scrutiny and more overall regulation. Trends for the future include a greater amount of cross-border and international planning as more Canadians have both assets and family members outside Canada, and with increasing inbound investment and immigration to Canada, in particular with the United States.

'Peace, Order and Good Government' is the motto on the Canadian coat of arms, and has sometimes been considered less than inspirational in defining a nation's core values. But in these times of global uncertainty, those values have rung true and proved themselves as critical to Canada's increasing political, economic and social eminence among other countries, which all bodes very well indeed for private clients and high net worth individuals in the Canadian context.

Appendix 1

ABOUT THE AUTHORS

MARGARET R O'SULLIVAN

O'Sullivan Estate Lawyers Professional Corporation

Margaret practises exclusively estate planning; estate litigation; advising executors, trustees and beneficiaries; and administration of trusts and estates. Prior to establishing an independent trusts and estates boutique firm, she was a partner at Stikeman Elliott where she directed its trusts and estates practice. She is a member of the Board of Directors and Council for Society of Trust and Estate Practitioners ('STEP') Worldwide; past chair of Professional Standards Committee of STEP Worldwide; past member of Management and Finance Committee; past deputy chair of STEP (Canada); and past chair of Editorial Board for STEP Inside; past chair, Trusts and Estates Section, Ontario Bar Association; elected fellow, ACTEC, 1995; member of council, Ontario Bar Association (1993–1998). She has authored two textbooks: *Engineering of a Trust* and *Trust and Estate Management for Trust Institute*, Institute of Canadian Bankers. She is author of the Canada chapter of *International Succession Laws* (Tottel 2009) and contributing author to *Widdifield on Executors and Trustees* (Carswell 2002) and *Key Developments in Estates and Trusts Law in Ontario* (Canada Law Book 2008). She was called to the Ontario Bar in 1983.

CLAUDIA A SGRO

O'Sullivan Estate Lawyers Professional Corporation

Claudia practises estate planning, administration and litigation at O'Sullivan Estate Lawyers. She has co-authored articles appearing in the *Windsor Review of Law and Social Issues* and the *Canadian Family Law Quarterly*. Prior to joining the firm, Claudia articled as a judicial law clerk at the Ontario Superior Court of Justice. She was called to the Ontario Bar in 2011.

O'SULLIVAN ESTATE LAWYERS PROFESSIONAL CORPORATION

Ernst & Young Tower
Toronto-Dominion Centre
222 Bay Street
Suite 1410
PO Box 68
Toronto
Ontario
M5K 1E7
Canada
Tel: +1 416 363 3700
Fax: +1 416 363 9570
mosullivan@osullivanlaw.com
www.osullivanlaw.com