The Private Wealth & Private Client Review

Third Edition

Editor
John Riches

Law Business Research

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THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

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EDITOR'S PREFACE

The scope and tone for my introductory remarks this year is set by referencing a combination of Henry Christensen and George Hodgson's articles. We all know that the Foreign Account Tax Compliance Act (FATCA) was a unilateral attempt by the United States to obtain information on the non-US financial interests of US citizen taxpayers. The response of other Organisation for Economic Co-operation and Development (OECD) countries has transformed from an initial stance of reticence and scepticism to one where FATCA has become the catalyst for the Common Reporting Standard (CRS). The publication in February 2014 by the OECD of the document entitled 'Standard for Automatic Exchange of Financial Account Information Common Reporting Standard'[1] paves the way for comprehensive disclosure on cross-border financial interests by individuals and related entities, and automatic exchange of that information by participating states from 2016. It is therefore worth pausing at this particular point in time to seek to discern what the aggregate effects of FATCA and CRS will be. Some may be less obvious than others.

Greater transparency

Starting with the obvious, it is apparent that for the families who are tax compliant with cross-border interests, and us as their advisers, greater transparency will create a different context within which planning is undertaken. We have become accustomed in more recent years to a 'self-assessment' paradigm where the burden of disclosure fell on individual taxpayers, who disclosed matters that they considered to be germane to the assessment of their tax affairs. In the post-FATCA/CRS world, this paradigm will change. Revenue authorities will be receiving significant amounts of spontaneous information about taxpayers' foreign financial interests through FATCA and CRS. Much of this

1 www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Common-Reporting-Standard.pdf.

information may duplicate data that has already been filed directly with the relevant individual's domestic tax authority, but nonetheless it is likely to create an environment in which more cross-checking of such data is undertaken, especially where it relates to entities such as trusts and foundations of which the individual is a beneficiary. This places a greater onus on advisers to ensure that our clients' tax filings are scrupulously accurate, as the overall trend seems set to be one in which revenue authorities are likely to adopt a less forgiving attitude to innocent mistakes.

Scrupulous compliance and record-keeping

It is also apparent that the maintenance of appropriate records will become more important. Tax authorities may not audit an individual's tax affairs for a number of years after these new initiatives take effect. When an audit occurs, it is likely to be important to be able to demonstrate that the structure did report the taxpayer's interest in relevant cases and to link this with the individual's personal tax filings where relevant.

Substance

A second, if less direct, consequence of transparency is the importance of ensuring that trusts, foundations and companies that are organised and resident in a particular jurisdiction have the appropriate substance there that can be demonstrated should the need arise. In a more transparent environment, the connections that exist between individuals as 'ultimate beneficial owners' and entities located in different jurisdictions will be more apparent. The policy thrust of seeking to identify not only settlors but those exercising oversight in a fiduciary capacity (such as protectors and enforcers) and those seen as 'exercising effective control' will mean that tax and regulatory authorities may be disposed to satisfy themselves that the operations of entities that are located in specific jurisdictions are being genuinely conducted there and that there are no 'short cuts' that are capable of generating a different tax analysis.

Anticipating this type of change, it would be prudent for those engaged in managing those entities to be in a position to demonstrate appropriate 'mind and management'. In this context, it will be critical to ensure that there is consistency between formal board or meeting minutes and informal communications with beneficial owners, properly conducted meetings held at the right time and sufficient time given for reflection before decisions are taken. This could be a good time to stress test substance given the enhanced likelihood of tax audits in future.

Scope for simplification

There may be instances where there is a 'silver lining' to the increased reporting burden. There is a basic precept of all planning that suggests that where one is in doubt, it is always better if possible to establish a simpler structure with fewer layers. The principal justification for this approach is that consequential changes are always more complex in structures where one has more 'moving parts' to address. When establishing new structures therefore, it may be that as advisers we will tend to be more sceptical about the value of the use of underlying companies and choose to hold assets, for example, directly at the level of the trust or foundation. Where existing compliant structures are concerned, both advisers and families may also be less inclined in future to embrace 'complexity' and prefer to concentrate on being able to demonstrate the substance of those layers that are required to execute the relevant planning objective. In this context it should not be forgotten that a key issue that creates greater complexity is the need to demonstrate the movement of value between layers in a structure, whether by way of loan repayment, dividend or appointment. It is also critical to note that where one is looking for flexibility and portability, a simpler structure is one that can be effectively 'lighter on its feet' should the need for change arise. This is not least demonstrated in the context of the requirement to provide comprehensive customer due diligence on the entire structure to relevant financial institutions or service providers.

Risk of confusion

There is undoubtedly going to be a scope for very significant confusion to arise with the advent of the new rules. For instance, the test of where an entity is deemed to be resident for the purposes of FATCA/CRS may well generate different outcomes. Some structures may be dual resident by being deemed to be resident in the country of incorporation as well as in the country of effective operation, and the initial stance of authorities at this point may be to prefer duplicate reporting where an entity falls to be treated as resident in more than one jurisdiction.

Another term open to significant ambiguity is that of 'any other natural person exercising ultimate effective control over the trust' referred to in the CRS definitions at Section VIII in the context of 'Controlling Persons'.[2] It is very uncertain at this stage how this phrase would be interpreted in the context of complex fiduciary structures. Is it, for instance, invoked by the use of reserved power trusts that may give administrative powers such as those relating to investment to a third party other than the settlor, or is it mainly intended to apply to dispositive powers? Will it apply to governance powers that allow a third party to intervene to hire and fire protectors, who can in turn appoint and remove trustees?

There are bound to be 'teething problems' of this nature, where both tax authorities and service providers will need clarity. What is essential is an ongoing engagement with policymakers that provides practical and usable guidance that minimises ambiguity.

Reporting profile of different fiduciary structures

At this early stage in the development of guidance on FATCA and CRS disclosure on entities, it is interesting to note that discretionary structures would appear to have a much lower reporting profile than those which revolve around the existence of fixed income interests. While there is no available CRS guidance in the public domain, there is analogous guidance in draft that has been published in the context of both FATCA and the United Kingdom's intergovernmental agreements (IGAs) with its Crown Dependencies (CDs) and certain of its Overseas Territories.[3]

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2 www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Common-Reporting-Standard.pdf

3 Draft CD Guidance was published in January 2014, while the Cayman Islands published its own draft guidance in May 2014

Specifically for trusts requirements to disclose information as a beneficiary will, in the case of a trust where an individual has an income interest, oblige, currently, a filing of underlying capital values of fiduciary assets while, in the case of discretionary trusts, the guidance directs that the disclosure should be limited to distributions made in the relevant year (this extract has been taken from the draft CD Guidance on FATCA and the United Kingdom IGAs issued on 31 January 2014):[4]

> *The total value of the assets of the trust must be consistent with that used by the trustees for valuation purposes and should be based on a recognised accounting standard. Listed securities should be valued at the appropriate market. The Equity Interest attributable to the settlor of any settlor interested trust is the whole value of the trust. Where a settlor is excluded from the trust, the Equity Interest can be considered to be nil but will still be a Financial Account and hence reportable.*
>
> *The Equity Interest of a beneficiary that is entitled to mandatory distributions (directly or indirectly) from a trust will be the net present value of amounts payable in the future and should be measured on a recognised actuarial basis. It is recognised that this may be difficult and expensive to calculate in which case it is permitted to use the accounting net asset value of the assets in which the beneficiary has an interest.*
>
> *For a discretionary trust, the Equity Interest attributable to a beneficiary in receipt of a distribution will be the amount of the distribution made in the relevant reporting year.*

The strongly contrasting nature of the level of disclosure required here may cause families and their advisers to reflect carefully on the merits of continuing with fixed interest structures.

As a separate matter, it is notable that settlor-interested structures are similarly ones where full disclosure of capital values on an annual basis will be required. It may be that in this environment settlors may choose to ring-fence their interests to a smaller portion of overall value on the basis that their personal financial needs will not require them to have access to the entire capital value of an ongoing structure.

Profile of fiduciaries

An inevitable consequence of the new rules for trusts will be a requirement to give greater disclosure about fiduciaries involved. This is implicit in the Financial Action Task Force guidance on fiduciary holding structures (see recommendation 25).[5] Where those acting, in particular, as protectors are required to provide information to authorities, families may wish to reflect on the merits of involving family friends or indeed close relatives in this capacity given that, in some cases, the inference that will be drawn by revenue authorities will be less positive than in circumstances where an independent third party is serving in this specific role.

4 www.gov.gg/CHttpHandler.ashx?id=86124&p=0.

5 www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

It will be interesting to see what will happen if the only nexus between a fiduciary holding structure and another jurisdiction is a resident protector with no other role. Will the protector's status be required to be reported on an otherwise nil return?

Tax transparent entities

Another possible consequence of the changes might be to favour structures that have legal substance but are accepted by authorities as tax transparent. In particular, the use of partnership entities may become more popular because of their ability to insulate fiduciaries from certain legal risks that arise from the direct ownership of assets in the same way as corporate entities, without generating the additional complexity of further 'layers'.

Public registers

In a European Union context, there is significant political support for certain information on trusts to be made public.[6] This has been linked to initiatives in the United Kingdom to make public beneficial owners of companies.[7] There are strong arguments that can be made to oppose trust registers, not least in the context of exposing vulnerable individuals to risk if the existence of trusts in which they are named beneficiaries falls into the public domain. What is clear though is that the imminent arrival of automatic exchange of information on a global basis under CRS and FATCA will mean that the information relevant to trusts and similar entities will be available to tax and regulatory authorities, which will have the capacity to create registers of their own. Thus the only open issue that remains is whether such information is confidential and only available to competent authorities or whether some will be placed in the public domain.

In summary, we are on the threshold of a new environment that is bound to generate a significant amount of change. Clients will be looking to us as advisers to do our best to help them plan effectively in this new environment.

John Riches
RMW Law LLP
London
September 2014

6 www.europarl.europa.eu/news/en/news-room/content/20140307IPR38110/html/Parliament-toughens-up-anti-money-laundering-rules.

7 www.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf.

Chapter 11

CANADA

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

I INTRODUCTION

i Canadian wealth: the long-term challenges of a mature economy

Of the list of the 20 strongest banks in the world, this small nation of just over 35 million people boasts five – of which Canadians, our regulators and business community can justifiably be proud. Canada's stable financial system has helped ensure that the Canadian economy emerge relatively unscathed from the fallout of the 2008 global financial crisis, at least so far. Good governance and one of the highest standards of living and highest qualities of life in the world make Canada an attractive place in which to live and invest.

Canada has always been a beacon for those seeking economic freedom and new opportunities – it is at its core a country of immigrants. Canada boasts one of the highest rankings in terms of aggregate household wealth and per capita wealth. Increasingly, Canadian wealth has also become more diverse, with immigrants, entrepreneurs and women taking significant forward strides.

A recent study[2] has found 67 per cent of Canadians who are millionaires with investable assets over C$1 million are 'self-made' and only about 20 per cent have derived their wealth from inheritance. In addition, 48 per cent are new or first-generation Canadians with at least one parent born outside the country. In comparison, the study found new Americans only account for about one-third of the wealthy in the United States. Women now make up one-third of Canadian millionaires, a sharp increase from 21 per cent only three years ago.

All of these factors highlight an open and tolerant Canadian culture, the abundance of available opportunities and the high level of mobility available for the ambitious.

1 Margaret R O'Sullivan practises and Claudia A Sgro formerly practised at O'Sullivan Estate Lawyers Professional Corporation.

2 'BMO Harris Private Banking Changing Face of Wealth Study', 13 June 2013.

However, continuing low interest rates and inflated prices across a number of asset classes have created fear of an impending bubble that may soon burst. Canadian residential real estate is now considered as one of the most over-valued real estate markets in the world. Furthermore, the Canadian economy is a mature one. Fundamental shifts may have occurred post-2008 that may have introduced new fragility in many economic sectors, primarily manufacturing, and permanent job losses, which raise challenges to future economic prosperity.

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 10 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 50 per cent in combined federal and provincial rates on taxable income above C$136,000 in a taxation year, less applicable tax credits. Surtaxes of a province can result in elevated effective tax rates.

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 that reduce the applicable rates.

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 at creating 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 2014, 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$800,000 in 2014) 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. Tax on capital gains may be deferred on certain transfers of property, for example, between spouses.

ii Developments relating to personal taxation

Provincial tax brackets for high earners

Personal tax rates remained constant for much of Canada in 2014, with the notable exception of new tax brackets and rates for high earners in some provinces. Ontario taxpayers with taxable income over approximately C$514,000 are subject to a combined federal and provincial rate of approximately 50 per cent in 2014, and the 2014 Ontario budget proposed to lower the taxable income threshold for the highest Ontario tax bracket to C$220,000. Nova Scotia has increased the tax rate for taxable income over C$150,000, resulting in a combined federal and provincial rate of approximately 50 per cent, initially as a temporary measure, which will now remain in place. British Columbia has increased the tax rate for taxable income over C$150,000 for two years commencing 1 January 2014. New Brunswick's tax rates increased for several tax brackets effective from 1 July 2013. The Quebec provincial tax rate has increased for 2013 and beyond to approximately 26 per cent for taxable income over C$100,000, based on a provincial definition of taxable income.

Revised federal legislation on the taxation of trusts

Certain estates and testamentary trusts have generally calculated federal tax using the graduated rates applicable to individuals, while trusts established during lifetime have been subject to the top federal marginal rate applicable to individuals. Following a public consultation, the federal government in the 2014 federal budget announced its intention to eliminate the graduated rates applicable to certain trusts and estates, and draft legislation has now been released. If the draft legislation is enacted, commencing in 2016 the top federal marginal rate will be applied to testamentary trusts and to estates after a reasonable period of administration of 36 months. Notwithstanding the changes, the graduated rates will continue to be available to 'graduated rate estates' for 36 months and to certain testamentary trusts having disabled beneficiaries who are eligible for the Federal Disability Tax Credit. Also, the draft legislation would change administrative requirements, including legislating a calendar year end for testamentary trusts commencing in 2016, or for existing testamentary trusts on 31 December 2015, and testamentary trusts will no longer be exempt from the general requirement to make instalment payments of income tax and will lose access to certain other exemptions.

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*,[3] also known as *Garron Family Trust* and *St Michael's Trust Corp*. The Supreme Court of Canada held that the residence of a trust is where the central management and control of the trust occurs, a significant change from the former focus on a trustee's residence.

General anti-avoidance rule in respect of income tax

There is increasing concern over the application of the general anti-avoidance rule (GAAR) in the Income Tax Act (Canada), which may apply to deny the tax benefit of provisions of the Income Tax Act (Canada) where certain conditions are met. In considering whether the GAAR applies, a court will generally consider 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. Several recent cases clarify the application of the GAAR.

In 2012, the Federal Court of Appeal held in favour of the Crown in three cases (*Triad Gestco*,[4] *1207192 Ontario Ltd*[5] and *Global Equity Fund Ltd*)[6] with somewhat similar facts and denied taxpayer-claimed losses based on the GAAR. Losses were claimed when shares of newly incorporated companies that had declared dividends were subsequently sold to family trusts. The trial court, being the Tax Court of Canada, had applied the GAAR in *Triad Gestco*, as there was an avoidance transaction with no real economic loss, but not in *1207192 Ontario Ltd*, where there was a creditor-proofing motivation for the transaction. On appeal of *Triad Gestco* and *1207192 Ontario Ltd* the Federal Court of Appeal found that certain provisions of the Income Tax Act, which provide relief for true economic losses, had been abused. In *Global Equity*, where there was no economic or business air of reality associated with the claimed business loss, the Federal Court of Appeal found an abuse of certain provisions of the Income Tax Act relating to business loss. Leave to appeal to the Supreme Court of Canada in *Global Equity* was dismissed.

3 *Fundy Settlement v. Canada*, 2012 SCC 14, [2012] 1 SCR 520.

4 *Triad Gestco Ltd v. Her Majesty the Queen*, 2012 FCA 258.

5 *1207192 Ontario Limited v. The Queen*, 2012 FCA 259.

6 *Global Equity Fund Ltd v. The Queen*, 2012 FCA 272.

In late 2011, the Supreme Court of Canada in *Copthorne Holdings Ltd v. Canada*[7] confirmed that 'contemplation' for the purpose of the GAAR can be interpreted retrospectively. With respect to an avoidance transaction or series of transactions, a series of transactions can include '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.

Whistle-blower rules, audit initiatives and compliance measures

CRA has launched the Offshore Tax Informant Program, under which the CRA will enter a contract to provide financial compensation to individuals who provide information that leads to the assessment or reassessment and collection of additional federal taxes in excess of C$100,000, and where the non-compliant activity involves property located outside Canada or certain other foreign elements. The 2013 federal budget also proposed that banks and other financial intermediaries be required to report international electronic funds transfers of C$10,000 and over, to the CRA. Such transfers are currently reported to Canada's Financial Transactions and Reports Analysis Centre (FINTRAC). The CRA's Related Party Initiative, is ongoing, under which individuals including high-net worth-individuals (generally over C$50 million) or those with complex planning using many related entities have been asked to provide detailed information and supporting documents about Canadian and foreign interests. Thresholds relating to value and complexity have been relaxed, and individuals not under audit are also being asked for such information. An aggressive tax planning reporting regime generally requires advisers to report to the CRA information concerning certain transactions on Form RC312 by 30 June of the following year. Reportable transactions or a reportable series of transactions will generally include an avoidance transaction or series of transactions for the purposes of GAAR if they feature two of the following: contingent fees, confidentiality protection or contractual protection. Where the form is not filed, denial of tax benefits and possible penalties may result.

iii Cross-border structuring

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.

Non-resident trusts and immigration trusts

Certain non-resident trusts established by non-resident settlors provided various conditions are met are exempt from tax and can distribute trust capital to specified beneficiaries tax-free, which provides tax planning opportunities where a non-resident

7 *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 SCR 721.

trust situated in a low-tax jurisdiction has Canadian resident beneficiaries. However, the opportunities for trust planning with non-resident trusts have been significantly curtailed by revised section 94 of the Income Tax Act (Canada), which prevents the avoidance of Canadian taxes by certain non-resident trusts with Canadian connections where there is a Canadian resident contributor or Canadian resident beneficiary by deeming these trusts to be Canadian resident and taxable on their worldwide income. Where a trust is deemed Canadian resident, Canadian resident beneficiaries can be liable for tax along with the trust.

Previously, an immigration trust could be set up to benefit an immigrant to Canada and his or her family, and the income and capital gains in the immigration trust could accrue tax-free for up to 60 months. If the trust was settled in a foreign jurisdiction (including a low-tax offshore jurisdiction) with foreign trustees who held the foreign investment assets, there could be significant tax savings depending on comparative tax rates. However, this planning opportunity was unexpectedly eliminated as a result of the 2014 federal budget. An immigration trust will be subject to tax on its worldwide income commencing on budget day or on 1 January 2015 for certain existing trusts, and the 60-month exemption from the deemed residence rule is eliminated.

Emigration from Canada

A taxpayer emigrating from Canada must pay a departure tax, which taxes gains on his or her property that 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. Due, however, to variations in the internal taxation law of treaty nations, there can be mismatches in tax credits and timing that 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). In 2014, Canada ratified an intergovernmental agreement (IGA) relating to the US Foreign Account Tax Compliance Act (FATCA), a US law that imposes strict reporting requirements to the US taxing authority, including on financial institutions located in Canada.

Foreign investment entity and foreign trust rules

Foreign trust rules designed to more effectively tax Canadian residents' passive investment, including in non-resident trusts, have been enacted, following numerous amendments to draft legislation over a protracted period. The non-resident trust rules deem a trust Canadian resident based on the presence of a Canadian-resident contributor, broadly defined, or a Canadian-resident beneficiary, and require tax to be withheld on distributions from trusts deemed Canadian resident, subject to exceptions. An election may be made to treat a portion of the trust as non-resident that will not generally be taxable in Canada. New provisions for taxing offshore investment funds have also been enacted, along with transitional provisions for those who filed under proposed foreign investment entity rules that were never enacted.

Canadian taxpayers holding specified foreign property outside Canada with a cost amount of C$100,000 or more, will be required to provide more detailed information about such property on a revised Form T1135, Foreign Income Verification Statement, including names of the countries and institutions where assets are held, foreign income earned on the assets, and a maximum cost amount of the assets in the year. Transitional rules for 2013 provide for streamlined reporting for certain foreign property. If Form T1135 is filed late or contains certain errors or omissions, the normal reassessment period is extended for three years, and severe penalties apply for failure to file.

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 2013, *Bloomberg Markets* magazine ranked five Canadian banks (Canadian Imperial Bank of Commerce, Royal Bank of Canada, Bank of Nova Scotia, Desjardins Group and Toronto-Dominion Bank) among the world's top 20 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.

In 1986, the federal government began to eliminate 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 and insurance and wealth management, which tend to be fairly uniform among the banks.

For Canada, 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 between 2007 and 2012. 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.

Preferential tax treatment is offered to a 'small business corporation', a defined term, which receives typical combined federal rates between 11 per cent to 16 per cent in the provinces, except Quebec, on the first C$425,000 to 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$800,000 in total indexed for inflation from 2014, as are certain qualified farm and fishing properties.

Investment income earned in a corporation is taxed at approximately the highest personal income tax rate (45 to 51 per cent in the various provinces). A gross-up and dividend tax credit mechanism is designed to avoid double taxation of dividends earned in a corporation that are subsequently paid to an individual. An amendment has been made to the gross-up and dividend tax credit mechanism such that dividends paid by a small business corporation will be grossed up by 18 per cent and the dividend tax credit will be 13⁄18 of the gross-up amount, which will now only partly compensate for the corporate tax paid.

A tax-deferred transfer or rollover 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 13 and 15 per cent.

III SUCCESSION

i Overview of succession in Canada

Provincial and territorial jurisdiction

In Canada, succession to property on death is generally a matter within the jurisdiction of the provinces and territories. Of Canada's 10 provinces and three territories, 12 are governed under common law, and one – the province of Quebec – under civil law. With respect to aboriginal Canadians who are subject to the Indian Act, succession to property on death falls within the jurisdiction of the federal government. Certain First Nations, however, have entered into self-government agreements that permit enactment of individualised laws including those that relate to succession. These two latter scenarios are beyond the scope of this chapter.

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 that governs private company shares and other assets that 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

In an event of 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 allocate 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, *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 dependants' 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

Property law in Canada falls under the jurisdiction of the provinces and territories; thus the availability and scheme of statutory property division claims by surviving spouses upon death of a spouse vary throughout Canada. The matrimonial property regimes of most provinces and territories provide a 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, he or she thereby loses entitlements, if any, under the deceased spouse's will and to certain other benefits. In New Brunswick, Newfoundland and Labrador, Ontario and Quebec, claims for division of property on death of a spouse are available to legally married spouses only as well as, in the case of Quebec, the survivor of a couple who have entered into a civil union. Currently, in British Columbia, Prince Edward Island and the Yukon, death does not trigger a statutory property claim for the surviving spouse. This is generally also the case in Alberta for the time being; however, under pending amendments to the Matrimonial Property Act death will be a triggering event for a marital property claim, but only for legally married spouses. All other provinces and territories provide a statutory claim to division of property on death and extend its availability to surviving *de facto* spouses provided the specific requirements of the governing legislation have been met.

ii Key legislative or case law changes affecting succession

Alberta's 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 the court's ability to rectify a will or purported will by adding or deleting text and admit extrinsic evidence for will interpretation. On intestacy, if the deceased's descendants are also those of the surviving spouse, the deceased's estate in its entirety will go to the spouse. Children who are full-time students aged 18 to 22 as well as minor grandchildren may be family members eligible for support. The testator's subsequent marriage or entrance into an adult interdependent partnership agreement does not revoke a pre-existing 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 came into force on 31 March 2014 and represents a significant updating, consolidation and harmonisation of that province's succession laws by repealing and replacing four statutes. 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 rectify wills and cure deficiencies, including orders for the validity of documents that do not meet statutory formality requirements based on substantial compliance considerations. 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.

Increased Ontario compliance to probate a will

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 well as making available other tax enforcement measures including audits and penalties. The Ontario government has continued to indefinitely defer the original implementation date of 1 January 2013.

Nova Scotia probate taxes, abolishment of rules against perpetuities and updated Variation of Trusts Act

While Ontario previously had the highest provincial probate tax rate at approximately 1.5 per cent, Nova Scotia's has surpassed Ontario's in recent years, with a current rate of approximately 1.645 per cent on a large estate, as of April 2013. This represents an increase of over 30 per cent since 2000 on a C$5 million estate, and is significantly greater than equivalent fees in other Atlantic provinces.

Nova Scotia's new Perpetuities Act came into force in July 2013 and for the most part abolished the rules against perpetuities in that province retroactively, with few exceptions. This change brings the number of provinces to three – Manitoba and Saskatchewan included – in which rules against perpetuities have been abolished entirely. Simultaneously, the Nova Scotia legislature updated the Variation of Trusts Act to expand the court's authority to maintain, vary or terminate trusts in light of certain considerations. Previously, a court had no power to vary or terminate trusts if an adult capable beneficiary objected.

Uniform Trustee Act

In August 2012, the Uniform Law Conference of Canada approved the Uniform Trustee Act. The Act is meant to serve as a model to the provinces and territories for the purpose of modernising trust law, as well as to some extent harmonising it across Canada. It would reform both the common law and statutory rules relating to a variety of matters, including the duties and powers of trustees, as well as trustee remuneration and the variation, termination and resettlement of trusts. Except for certain mandatory provisions considered essential to the operation of trusts, a trust deed may exclude and override the operation of the Act's provisions, which function as default rules when the trust deed is silent. Each province and territory must now consider adopting and implementing the Act. In 2014, British Columbia's Ministry of Justice undertook a public consultation on the Act as a basis for new legislation in that province.

Marriage and pre-existing wills

In some common law provinces (e.g., Ontario), marriage generally continues to revoke a pre-existing will by operation of statute. In *Davies v. Collins*,[8] the Nova Scotia Court of Appeal was asked to consider the conflict of laws rules where a testator marries and is domiciled in one jurisdiction, subsequently dies and is domiciled in another jurisdiction, had a pre-existing will at the time of marriage and each jurisdiction has different rules governing the effects of marriage on the will. The court found it to be the law of the domicile of the testator at the time of the marriage that will determine whether a pre-existing will is revoked by operation of law – irrespective of whether the estate encompasses real or personal property, as well as where the property is located.

8 *Davies v. Collins*, 2010 NSSC 457.

iii Cross-border developments

Changes to US transfer tax

Canada is home to many dual citizens including US–Canadian citizens and many Canadians own holiday 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. Following the American Taxpayer Relief Act of 2012, which became law on 2 January 2013, the US exemption from estate tax remains US$5 million indexed for inflation from 2011 (US$5.34 million for 2014) and the maximum rate of US estate tax increased from 35 per cent to 40 per cent, both permanently subject to future legislation. Where applicable, the US estate and gift tax exemption remains unified.

Income tax-related reporting requirements

FATCA, introduced to combat offshore tax evasion, will affect Canadians with US connections and Canadian financial institutions. Final regulations under FATCA set out detailed reporting and withholding requirements for non-US financial institutions with respect to accounts with certain US connections including those beneficially owned by US citizens. The requirements under FATCA will be phased in generally ending in 2017. Information to be reported includes identifying information, information about the values of the accounts, and transaction amounts. Other non-US entities (and it is expected certain Canadian trusts) will also be required to report the ownership or beneficial interests of US citizens.

Under FATCA, such information is generally required to be provided directly to the US Internal Revenue Service (IRS) by non-US financial institutions and entities. Canada has ratified a Model 1 type IGA with the United States and passed legislation that aims to implement the IGA. Designed to ease compliance with FATCA, the IGA modifies FATCA's provisions in respect of Canadian financial institutions and other Canadian entities, and expands the tax information exchange provisions between Canada and the United States. Pursuant to the IGA, Canadian financial institutions will generally report information to the Canada Revenue Agency rather than directly to the IRS, although they are generally required to register with the IRS to obtain an identification number. It is intended that by complying with the IGA, Canadian financial institutions will avoid a 30 per cent withholding requirement under FATCA on certain payments to them. Also, certain Canadian registered plans are exempt from reporting under the IGA, and local financial institutions may be entitled to additional relief.

It is unclear exactly what obligations trusts with Canadian resident trustees will have under FATCA and the IGA if it applies. It seems clear that certain trusts may be considered foreign financial institutions under FATCA. Other trusts may be considered passive non-financial foreign entities and the trustees are required to report information about US interest holders. Alternately, certain trusts are considered by US law to be owned by the settlor. It is unclear what effect, if any, the IGA will have on the reporting and compliance requirements for trusts including those considered foreign financial institutions under FATCA, since Canada's IGA, unlike the United Kingdom's, does not expressly address trusts.

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 United States) in Canada and elsewhere that may require reporting of non-US bank and financial accounts on a Report of Foreign Bank and Financial Accounts. Under FATCA, US persons must generally also report certain non-US financial assets exceeding threshold values on a Statement of Specified Foreign Financial Assets (Form 8938), filed with their tax returns.

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. The US Internal Revenue Service has provided measures to assist such persons to fulfil their filing and reporting obligations. In June 2014, the IRS announced streamlined filing compliance procedures for certain US taxpayers who non-wilfully failed to disclose offshore assets, eliminating former requirements that taxpayers owe US$1,500 or less per taxation year and a former risk questionnaire, and requiring a certification regarding the taxpayer's non-wilful conduct. Certain penalties or enforcement actions may be avoided, and taxpayers may claim retroactive deferral of income earned in Canadian retirement plans. The IRS also announced its intention in June 2014 to modify the 2012 offshore voluntary disclosure programme.

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 in Quebec

In early 2013, the Supreme Court of Canada delivered its decision in *Quebec (Attorney General) v. A*,[9] also known as *Lola v. Eric*. Lola (not her real name) claimed spousal support and property rights from her billionaire *de facto* spouse Eric. The province of Quebec has a greater percentage of *de facto* spouses than any other province (approximately 32 per cent in 2011, with the national average being 16.7 per cent) and there are few

9 *Ford v. Quebec (Attorney General)* [1988] 2 SCR 712.

legal rights provided to these spouses on relationship breakdown.[10] While a majority of the Supreme Court agreed with the Quebec Court of Appeal in finding 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, discriminates against *de facto* spouses on equality grounds, the discrimination is justified on the principle of respecting individual couples' choice and autonomy.

Common law property division for de facto spouses

In *Kerr v. Baranow and Vanasse v. Seguin*,[11] 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 in British Columbia

British Columbia's new Family Law Act came into force in early 2013. The Act reforms property division in the province by granting equal status to married and *de facto* spouses[12] upon separation under the property and pension division provisions – a marked departure from the prior statutory regime. As noted earlier, no provision has been included to allow a surviving spouse to claim an entitlement to matrimonial property as against the estate of a deceased spouse (i.e., separation is the only 'triggering event' to make a property claim). In dividing property between spouses, the Act moves away from the 'family use' test by including provisions for dividing 'family property' (formerly 'family assets') and identifying 'excluded property'. While excluded property will not be divided, the amount of the increase in value during the relationship will be divided. The expanded definition

10 Statistics Canada, 'Portrait of Families and Living Arrangements in Canada: Families, households and marital status, 2011 Census of Population', September 2012, p. 6.

11 [2011] SCJ No. 10.

12 Common law couples who have lived together in a marriage-like relationship for at least two years or who have lived together in a marriage-like relationship and have a child with each other, regardless of the length of cohabitation.

of spouse has also been picked up in the parts of the Act that deal with spousal support, child support and custody. In addition, the Act permits a court to order a spouse, based on certain factors, to continue to make spousal or child support payments after death. Guardians are permitted to hold property for a minor if the value of the property is 'small' (currently C$10,000 or less).

Discretionary trust interests as matrimonial property

British Columbia's Family Law Act is the first Canadian family law statute to expressly address discretionary trust interests in the division of family property by categorising certain beneficial interests in property held in discretionary trusts as excluded property. Problems with the original wording of the Act have been rectified by amendments that came into force on 26 May 2014, thereby clarifying that only the increase in value of the spouse's beneficial interest in a discretionary trust will be subject to division on separation (rather than the increase in value of all of the property in the trust, as originally drafted). Valuation of these interests on separation will continue to remain a live and litigious issue in this province and throughout Canada, as evidenced by recent reported decisions in Saskatchewan[13] and Alberta,[14] with no helpful valuation analyses having been reported to date.

Legal presumptions relating to jointly held personal property clarified and effect of transfer examined

In two companion cases, *Pecore v. Pecore*[15] and *Madsen Estate v. Saylor*,[16] 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 that 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. In *Bradford v. Lyell*,[17] a Saskatchewan court recently held that if an *inter vivos* transfer of a condo property into joint ownership by a grandmother to her granddaughter was found to be intended as a gift of the right of survivorship at the time of the transfer, both the legal and equitable title vested when the joint title was created such that gift was complete at that time and the grandmother could not later change her mind in her will, thereby entitling the granddaughter to the beneficial ownership of the property upon the grandmother's death.

13 *Grosse v. Grosse*, 2012 SKQB 464 (CanLII)

14 *Shopik v. Shopik*, 2014 ABQB 41 (CanLII)

15 *Pecore v. Pecore*, 2007 SCC 17.

16 *Madsen Estate v. Saylor*, 2007 SCC 18.

17 *Bradford v. Lyell*, 2013 SKQB 330 (CanLII)

A recent Ontario Court of Appeal decision has added a further outcome to gratuitous transfers of property into joint ownership in finding that evidence of intention regarding the transfer may not only show that the presumption of resulting trust has been rebutted, but also that a transfer of personal property into joint names created a trust of the beneficial right of survivorship for certain beneficiaries in addition to the surviving joint owners (two of the deceased's children) such that the property passed outside the deceased's estate and was divided equally among all five of the deceased's children.[18]

Requirements of a 'course of dealing' to sever a joint tenancy clarified

In *Hansen Estate v. Hansen*,[19] the Ontario Court of Appeal clarified what constitutes a 'course of dealing' such that a joint tenancy is severed under the third rule of severing joint tenancies and thereby deeming the parties to hold the property as tenants in common. The parties were married at the time of the husband's death but were in the process of separating. Each had children from prior relationships and owned a matrimonial home together as joint tenants. The entirety of the co-owners' course of conduct must be examined in discerning whether the parties intended to mutually treat their interests in the property as constituting a tenancy in common, and each case will turn on its own unique facts. In this instance, an exchange of letters by lawyers, the dividing of joint accounts and the moving out of one spouse were sufficient to establish a course of dealing to sever the joint tenancy.

Exempting matrimonial property from the equalisation regime

The recent Ontario Court of Appeal decision in *Spencer v. Riesberry*[20] held that in the circumstances, a matrimonial property held by a family trust where one of the beneficiaries resided did not qualify as a matrimonial home for the purposes of Ontario's Family Law Act and excluded it from the equalisation calculation as the beneficiary in question did not have an 'interest' in the property within the meaning of the Act (although the value of the interest in the trust was still included for the purposes of the calculation). This case represents a frustration of the matrimonial home protection contained in the Act, as well as a potential circumvention of the usual requirements for the spouse's consent on the sale or encumbrance of a matrimonial home and the right of possession for the non-titled spouse.

18 Sawdon Estate, 2014 ONCA 101 (CanLII)

19 *Hansen Estate v. Hansen*, 2012 ONCA 112.

20 *Spencer v. Riesberry*, 2012 ONCA 418.

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 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 that are specifically defined under Canadian income tax legislation and allow persons aged 65 and over, 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; and (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, have been used to provide for income splitting on death. Generally, certain estates and testamentary trusts calculate federal tax using the graduated rates applicable to individuals, whereas trusts established during lifetime are subject to the top federal marginal rate applicable to individuals. At the time of writing, 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. However, in 2014, the federal government released draft legislation that, if enacted, will provide that all income in a testamentary trust will be taxed at the top marginal tax rate commencing in 2016, but with the exception that graduated rates will continue to apply to the estate for 36 months and to certain testamentary trusts with disabled beneficiaries. The proposed changes will eliminate certain tax benefits of income splitting with testamentary trusts, but it will still be possible to 'sprinkle' income among a group of beneficiaries of a discretionary trust if the trust terms permit this. 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 that 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 also are 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 also 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

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

The Canadian economy and general investment climate has stood the course over the last several years since the 2008 financial collapse. But what lies on the horizon? Is there a fundamental shift in the Canadian economy, in particular in the manufacturing sector, which with jobs lost permanently simply will not regain its place, notwithstanding a now cheaper Canadian dollar and the hope of increased exports as a result? As a mature economy, will growth only be restrained and moderate for the long term, putting pressure on a shrinking income tax base with an aging workforce as baby boomers shift into their retirement years? The risk remains that the Canadian economy will fall into recession in the short term and the prolonged housing bubble in Canada, where prices have continued to rise, will finally burst and be the primary catalyst for an economic slowdown and subsequent fallout.

New tax initiatives have demonstrated the authorities' focus on tax evasion and abusive and aggressive tax arrangements, including the nefarious introduction of 'whistle-blower' rules. Long-establishing tax planning has now been eliminated as a result of the 2014 Canadian budget – including the preferential tax treatment of testamentary trusts and the unexpected elimination of the five-year immigration trust.

Modernisation of succession law in the western provinces, including British Columbia, whose new legislation came into effect on 31 March 2014, pending legislation in Alberta, and a new proposed Uniform Trustee Act, which is now being considered with a public consultation initiated in British Columbia, are all good news for the private client sector and will hopefully trigger a modernisation trend in other Canadian jurisdictions, in many long overdue.

Appendix 1

ABOUT THE AUTHORS

MARGARET R O'SULLIVAN

O'Sullivan Estate Lawyers Professional Corporation

Margaret O'Sullivan exclusively practises 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 past deputy chair, and member of the board of directors and council for the Society of Trust and Estate Practitioners (STEP) Worldwide; past chair of the professional standards committee of STEP Worldwide; past member of the management and finance committee; past deputy chair of STEP (Canada); and past chair of the editorial board for *STEP Inside*; past chair of the Trusts and Estates Law section, Ontario Bar Association; elected fellow, ACTEC, 1995; and member of council, Ontario Bar Association (1993–1998). She received the Ontario Bar Association's 2013 Award of Excellence in Trusts and Estates Law. She has written two textbooks for the Trust Institute of the Institute of Canadian Bankers: *Engineering of a Trust* and *Trust and Estate Management*. She is also author of the Canada chapter of *International Succession Laws* (Tottel 2009) and contributing author to *Widdifield on Executors and Trustees* (Carswell 2002), *Key Developments in Estates and Trusts Law in Ontario* (Canada Law Book 2008) and to *The International Comparative Legal Guide to: Private Client 2014* (Global Legal Group 2013). She was called to the Ontario Bar in 1983.

CLAUDIA A SGRO

Formerly of O'Sullivan Estate Lawyers Professional Corporation

Claudia Sgro formerly practised estate planning, administration and litigation at O'Sullivan Estate Lawyers. She has authored a case comment appearing in *Money and Family Law* and has presented to the Canadian Bar Association's trusts and estates section. In addition 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, Ms Sgro 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
Toronto-Dominion Centre
Ernst & Young Tower
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