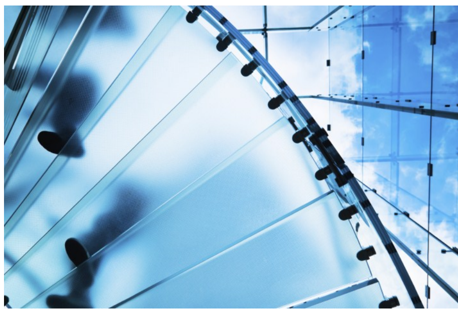
WESTWARD ADVISORS

2012 CRA Roundtable at
STEP Conference



THE ISSUE

On June 12, 2012, the Canada Revenue Agency (CRA) once again attended the annual STEP National Conference in Toronto for a Roundtable session.

In a packed agenda, the CRA responded to sixteen questions on issues relevant to trust and estate planning in Canada.

The questions covered a range of issues including capital losses arising on death, joint tax liabilities upon marital breakdown, deductibility of amounts payable by trusts, income accruals in the year of death, shareholder loan "debits" on death, commencement dates of testamentary trusts, electing out of spousal rollovers, high net worth audits, interest deductibility, and the residence of trusts.

Wayne Stone, CA and Paul Biln, CA attended the STEP Conference and report firsthand on the Roundtable questions relevant to the use of life insurance in estate planning.

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WESTWARD'S VIEWPOINT

The following Roundtable questions are relevant to the use of life insurance in estate planning.[1]

Interest Deductibility

The CRA confirmed that an individual can continue to deduct interest on borrowed money used to acquire an income producing property after transferring that property to a reversionary trust (such as an alter-ego trust) that attributes the income from the property back to the individual. In the context of life insurance planning, the individual's debt may be secured by a collateral assignment of a life insurance policy such that the net cost of pure insurance is deductible, but only if the interest is also deductible. The CRA's answer eases uncertainty in this area and avoids unnecessary transactions aimed at preserving interest deductibility.

Estate Capital Loss Carrybacks

The CRA confirmed a circularity problem that might eliminate an estate's capital loss that would otherwise be carried back to the terminal tax return of the deceased and applied against capital gains deemed to arise on death. A capital loss can be created in an estate if the estate holds shares of a private company that are redeemed in the first taxation year. Corporate-owned life insurance is often used to fund such a redemption of shares, providing liquidity in the estate for the taxes owed on death, while simultaneously triggering a capital loss to reduce the taxes otherwise payable. While acknowledging the unintentional but potentially devastating circularity problem, the CRA could only suggest avoiding the cause of the problem by taking steps to avoid triggering capital gains in the first taxation year of the estate.

Commencement of a Testamentary Trust

The CRA confirmed its view that a testamentary trust created under the terms of a taxpayer's Will commences on the date of death. Life insurance is sometimes used to fund a testamentary trust, but the proceeds of the life insurance are not received by the trust until the claim is processed. The CRA's response clarifies that the trust nevertheless exists from the date of death, which is consistent with the trust's legal position to enforce its claim against the insurer.

Spousal Rollovers

The CRA confirmed that the election to "opt out" of the spousal rollover provisions may not be made on part of the value of a share. Corporate-owned life insurance is sometimes used to redeem shares from a surviving spouse on a tax-free basis with the capital dividend account, after the surviving spouse receives those shares via a spousal rollover from the deceased spouse, completely eliminating the capital gains death tax exposure on those shares. It could be beneficial to enhance this "roll and redeem" strategy by opting out of the rollover on some of the shares to take advantage of the lifetime capital gains exemption. This planning will be defeated if the deceased owns a single share because one cannot opt out of the rollover on part of the value of a share, only the share itself.

[1] This summary is based on the Roundtable discussion and is not the CRA's official response, which has yet to be published.

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