NEW DEVELOPMENTS AND CASES IN ESTATE PLANNING

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There have been a number of interesting developments in estate planning during the past year. The first two developments considered here come out of the Court of Appeal for Ontario. The first development addresses the competing interests of the family members and the creditors of a deceased. The second development also addresses the interests of the family members of a deceased, but in the context of balancing those interests against a deceased's testamentary freedom. Both developments augment the rights of family interests in estate circumstances. Two new initiatives of the Department of Finance and the Canada Revenue Agency ("CRA") further restrict current estate planning opportunities. The first is an income tax directive from Canada Revenue Agency signalling the end of special tax treatment for single purpose corporations. The second is proposed legislation expanding the affiliated persons rules in the *Income Tax Act* to apply to trusts. As a result of these new developments, greater and more careful and targeted planning now needs to be undertaken to ensure that these changes do not deprive taxpayers of possible available estate planning benefits.

RRSP CREDITOR-PROOFING USING A DESIGNATED BENEFICIARY

Amherst Crane Rentals Ltd. v. Perring[2]

In a noteworthy judgment rendered June 14th, 2004, the Court of Appeal for Ontario held that RRSP proceeds devolve directly to a designated beneficiary and do not form part of the deceased's estate. As well, Feldman J.A. writing for a unanimous Court held that the creditors of the deceased have no claim against the RRSP proceeds in the hands of the designated beneficiary.

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[2] 241 D.L.R. (4th) 176 (C.A.) [*Amherst Crane*].

The appellant in *Amherst Crane* was a creditor of the deceased. The respondent was the widow of the deceased and the designated beneficiary of two RRSP funds. The estate of the deceased declared bankruptcy and the creditor sought to obtain payment of the outstanding debt from the beneficiary out of the proceeds of the RRSPs. Cameron J. at first instance[3] also denied the creditor recovery. He dealt with two main issues:

1. **Do the proceeds of an RRSP form part of the deceased's estate?**

2. **Do creditors have a claim against the RRSP proceeds in the hands of the beneficiary?**

With respect to the first issue, Cameron J. held that RRSPs do not form part of the estate of the deceased but instead devolve directly to the designated beneficiary. Regarding the second issue he held that the creditor had no right to seek repayment of the debt from the proceeds of the RRSPs in the hands of the designated beneficiary.

Issue 1 – Do the proceeds of an RRSP form part of the deceased's estate?

In *Canadian Imperial Bank of Commerce v. Besharah*[4], the first case to address the issue of whether an RRSP devolves to a designated beneficiary, the court held that under section 2(1) of the *Estates Administration Act*[5], the deceased's vested RRSP devolved to his personal representative. Section 2(1) provides:

> 2(1) All real and personal property that is vested in a person without a right in any other person to take by survivorship, on the person's death, whether testate or intestate and despite any testamentary disposition, devolves to and becomes vested in his or her personal representative from time to time as trustee for the persons by law beneficially entitled thereto, and, subject to the payment of the person's debts and so far as such property is not disposed of by deed, will, contract or other effectual disposition, it shall be administered, dealt with and distributed as if it were personal property not so disposed of.

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[3] *Amherst Crane* [2002] O.J. No. 2792 (Sup. Ct.) [*Amherst Crane (lower court)*].

[4] (1989) 68 O.R. (2d) 443, 58 D.L.R. (4th) 705 (H.C.J.) [*Besharah*].

[5] R.S.O. 1990 c. E.22.

The Court in *Amherst Crane* noted that counsel in *Besharah* did not refer the trial judge to section 53 of the *Succession Law Reform Act*[6] which provides:

> 53. Where a participant in a plan has designated a person to receive a benefit under the plan on the death of the participant,
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> (a) The person administering the plan is discharged on paying the benefit to the person designated under the latest designation made in accordance with the terms of the plan, …; and
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> (b) The person designated may enforce payment of the benefit payable to him under the plan but the person administering the plan may set up any defence that he could have set up against the participant or his or her personal representative.

This section is crucial to the court's reasoning about whether the RRSP proceeds devolve to the estate or to the designated beneficiary. Cameron J. at first instance held that this section excludes the personal representative of the deceased owner of the RRSP from any right to enforce payment of the proceeds of a fund where there is a designated beneficiary, and is an exception for RRSPs from section 2(1) of the *Estates Administration Act*. The Court of Appeal relied on the Supreme Court of Canada decision in *Kerslake v. Gray*[7] to conclude that Cameron J.'s conclusion was correct. The issue in *Kerslake* was whether a life insurance policy made payable by a declaration by the deceased under the *Insurance Act*[8] to an ordinary beneficiary formed part of the estate of the deceased. The *Insurance Act* specifically provided that insurance moneys payable to a preferred beneficiary were held in trust for the preferred beneficiary, were not subject to the control of the insured or his creditors and did not form part of the insured's estate. The section applicable to ordinary beneficiaries did not so provide. Rather, it was very similar to the current section 53 of the *SLRA*. The Supreme Court held that the personal

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[6] R.S.O. 1990, c. S.26 [*SLRA*].
[7] [1957] S.C.R. 516, 8 D.L.R. (2d) 705 [*Kerslake*].
[8] R.S.O. 1950, c. 183.

representatives of the deceased insured had no claim to moneys that were payable under an insurance policy to an ordinary beneficiary.

Cameron J. found further support for his conclusion in section 72(1) of the *SLRA*. This section lists a number of transactions by a deceased, the proceeds of which are deemed to be included as part of the deceased's estate for the purpose of making and enforcing orders for dependant's relief. Section 72(1) provides:

> 72. (1) Subject to section 71, for the purpose of this Part, the capital value of the following transactions effected by a deceased before his or her death, whether benefiting his or her dependant or any other person, shall be included as testamentary dispositions as of the date of the death of the deceased and shall be deemed to be part of his or her net estate for the purposes of ascertaining the value of his or her estate, and being available to be charged for payment by an order under clause 63(2)(f),
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> …
>
> (g) any amount payable under a designation of beneficiary under Part III.

Cameron J. contended that the existence of this section implies that the transactions listed in the section are not otherwise testamentary disposition and their proceeds do not actually form part of a deceased's estate. "If an RRSP is part of the estate, s. 72(1)(g) is meaningless, a result the law abhors."[9]

Issue 2 – Do creditors have a claim against the RRSP proceeds in the hands of the beneficiary?

Cameron J. declined to follow the Manitoba Court of Appeal in *Clark Estate v. Clark*[10]. The Court of Appeal affirmed this result. In that case the Court concluded that the proceeds of an RRSP in the hands of a designated beneficiary were available to creditors if there were

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[9] *Amherst Crane (lower court) supra* note 3 at para. 15.

[10] [1997] M.J. No. 19, 15 E.T.R. (2d) 113 [*Clark Estate*].

insufficient funds in the estate to satisfy the creditors of the deceased. The analysis in *Clark Estate* was as follows: (1) there is no specific statutory exemption from creditors for RRSP proceeds; (2) unlike life insurance proceeds that never belonged to the deceased, RRSP proceeds did belong to the deceased before death and were answerable for the owner's debts; (3) therefore, if the estate cannot pay the debts, the proceeds should be available in the hands of the beneficiary to respond to the claims of creditors, because creditors rank ahead of a volunteer; (4) sections 14 and 15 of the *Retirement Plan Beneficiaries Act*[11], the equivalent of section 53 of the *SLRA*, is only a mechanism for the payment of the RRSP proceeds to the beneficiary and does not immunize those proceeds from the claims of creditors of the deceased.[12] Cameron J. disagreed with this conclusion and stated that once the RRSP proceeds devolve to the designated beneficiary, there is no security interest in the proceeds in favour of creditors or any other means by which the proceeds remain liable to the claims of creditors. As with jointly-held property, prior to death the creditors of each owner can claim the owner's share of the property, but upon the death of one owner, the whole property vests in the surviving joint tenant and the creditors have no further claim against the property.[13] With respect to the life insurance argument, Cameron J. pointed out that some insurance policies have a cash surrender value that can be dealt with by an insured during his or her lifetime and therefore potentially be claimed by creditors during the life of the insured. Cameron J. also looked at the policy considerations behind RRSPs.

> Many, I dare venture most, RRSPs designate the spouse of the holder as the beneficiary since the purpose of the RRSPs under the *Income Tax Act* is to encourage people and couples with earned

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[11] S.M. 1992, c. 31, C.C.S.M. c. R138.

[12] *Amherst Crane (lower court) supra* note 3 at para. 26.

[13] *Ibid*. at para. 28.

> income to provide an income for themselves and their spouses following retirement. One cannot easily say a creditor has such a higher entitlement that the RRSP should not be immune from creditors' claims following death. A loyal and dedicated spouse provides consideration such as emotional support, homemaking, child rearing, and labour in a family business and assistance in a spouse's enterprises worthy of compensation by way of a pension. A spouse is often also a dependant deserving of support from the deceased's estate.[14]

The Court of Appeal agreed with this analysis and stated that "[t]he beneficiaries are often spouses, and therefore, not volunteers in the traditional sense, but partners in life, who have provided support to their spouses with the expectation that they will be supported after the death of their spouses."[15] The Court of Appeal also cited potential procedural difficulties with allowing creditors to pursue beneficiaries directly for the proceeds of RRSPs in their hands. The Court stated "…in order to give full effect to s. 53 as an exemption from the rule that an RRSP designation is a testamentary disposition, and following *Kerslake*, it would be anomalous to hold that RRSP proceeds that have devolved to the designated beneficiary remain subject to the claims of the creditors of the deceased."[16] The Court concluded that the effect of section 53 of the *SLRA* is to protect RRSP proceeds in the hands of a designated beneficiary from the claims of creditors of a deceased's estate.

The State of the Law Prior to *Amherst Crane*

Amherst Crane overrules an older line of caselaw that began with *Besharah*. In *Besharah*, the trial judge held that the proceeds of an RRSP with a designated beneficiary devolved to the deceased's estate to be paid out to the designated beneficiary after the creditors of the estate were satisfied. The trial judge reasoned as follows: (1) the RRSP was vested in the deceased during his life and the designated beneficiary had no vested interest in it until his death; (2) under

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[14] *Amherst Crane (lower court) supra* note 3 at para. 25.

[15] *Amherst Crane supra* note 2 at para. 33.

[16] *Ibid*. at para. 34.

section 2(1) of the *Estates Administration Act*, the deceased's vested RRSP devolved to his personal representative; (3) counsel could not refer the court to any statutory exemption from the general rule, applicable to RRSPs, comparable to the section of the *Insurance Act*[17] which provides that proceeds of a life insurance policy devolve directly to the designated beneficiary, not to the estate and are not subject to the claims of creditors of the estate.

Besharah was followed in two cases out of Manitoba. The Court of Queen's Bench in *Waugh Estate v. Waugh*[18] held that the RRSP proceeds in question passed to the deceased's personal representative for distribution. Although specific bequests could be available for contribution towards payment of the claims of the creditors of the estate, residual bequests or unspecified personalty ought to be drawn upon first. The second case to follow *Besharah* was the decision of the Manitoba Court of Appeal in *Pozniak Estate v. Pozniak*[19]. In that case the Court held that the RRSP proceeds were to pass to the estate and to be treated by the executor as a specific bequest in its distribution.

The Manitoba Court of Appeal in *Clark Estate* set the jurisprudence on a different course, a course that has reached its conclusion, at least for now[20], in *Amherst Crane*. As discussed above, the Manitoba Court of Appeal in *Clark Estate* held that RRSP moneys flow directly to a designated beneficiary under the *Retirement Plan Beneficiaries Act* but "…it does not necessarily follow that those moneys are immune from the claims of creditors of the estate".[21] The court in

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[17] R.S.O. 1980, c. 218 s. 173(1), now R.S.O. 1990, c. I.8 s. 196.
[18] (1990) 63 Man. R. (2d) 155, 37 E.T.R. 146 [*Waugh Estate*].
[19] [1993] M.J. No. 344, 50 E.T.R. 114 [*Pozniak*].
[20] Leave to appeal to the Supreme Court of Canada was filed on September 30th, 2004.
[21] *Clark Estate supra* note 10 at para. 25.

Clark Estate did not say that the RRSP moneys in the hands of the beneficiary were an asset of the estate, but since the assets were not in the hands of the executor and trustee, and the executor and trustee had no right or obligation to seek the funds, the creditor must lay claim to the funds in the hands of the beneficiary. The court in *obiter* observed "…the claim of a creditor would seem to rank ahead of the claim of a beneficiary who has given no consideration".[22] Similarly, in *obiter,* the court stated "… [t]he claim of the designated beneficiary of an RRSP contract or scheme would seemingly be superior to that of other volunteers, such as specific legatees or residual legatees under the will".[23]

Anne Werker, in her article titled "Non-Insurance RRSP Designations – Testamentary Disposition of Property That Do Not Form Part of the Estate"[24], discusses two troubling aspects of the *Amherst Crane* trial decision that are worthy of note. First she criticizes the comparison made by Cameron J. between an RRSP beneficiary and a joint tenant.

> Cameron J. states that RRSP proceeds are like "jointly held property, title to which, on the death of the joint tenant, vests in the surviving joint tenants free of claims from creditors". But there is no unity of interest as between the planholder and the designated beneficiary; there is no right of survivorship; and the rule that [the right of survivorship is preferred to encumbrances] is not applicable.[25]

Werker also criticizes the policy argument in *Amherst Crane*, perhaps the most troubling aspect of both the trial and appellate decisions.

> Cameron J.'s belief that the deceased's spouse has a credible claim is … without foundation. It would take a lot more evidence and reasoning than Cameron J.'s statement that "a loyal and dedicated spouse provides consideration such as emotional support, homemaking, child rearing,

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[22] *Ibid.* at para. 28.

[23] *Ibid*. at para. 31.

[24] (2003) 22 E.T.P.J. 103.

[25] *Ibid.* at 124-125.

> labour in a family business and assistance in a spouse's enterprises worthy of compensation by way of pension" to justify the spouse's proprietary claim to the entire asset.[26]

The Court of Appeal noted, "[t]he beneficiaries are often spouses, and therefore, not volunteers in the traditional sense, but partners in life, who have provided support to their spouses with the expectation that they will be supported after the death of their spouses".[27] Similarly, at first instance Cameron J. remarked, "[a] spouse is often also a dependant deserving of support from the deceased's estate."[28] But the legislation provides ample opportunity for spouses to claim support from the estate of a deceased spouse. Part V of the *SLRA*, specifically section 58, empowers a court to make an order for the support of a dependant of a deceased person where the deceased person has not made adequate provision for the proper support of his or her dependants. Also, Part I of the *Family Law Act* allows the spouse of a deceased to either take under the deceased's will or receive ½ the difference between their net family properties.[29] Surely the dependants of a deceased person are adequately protected under these provisions. RRSP proceeds paid to a designated beneficiary are now completely immune from a deceased's creditors. In the typical scenario, the bulk of a deceased's estate will comprise a house, probably held in joint-tenancy, and an RRSP or RRIF with a designated beneficiary. There will be very little for unsecured creditors to claim now that RRSP proceeds are unavailable to them. The decision in *Amherst Crane* really leaves such creditors in the lurch.

An application for leave to appeal the decision in *Amherst Crane* to the Supreme Court of Canada was filed on September 30th, 2004. Given the patchwork that exists across Canada in

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[26] *Ibid.* at 125.
[27] *Amherst Crane supra* note 2 at para. 33.
[28] *Amherst Crane (lower court) supra* note 3 at para. 25.
[29] R.S.O. 1990, c. F.3, ss. 5-6.

this area, one would hope that leave will be granted in this case. If leave is granted, one can only speculate how the court will decide this case. Currently, Saskatchewan, Manitoba and Ontario have virtually identical provisions regarding an RRSP designated beneficiary's right of enforcement as against the plan administrator, and yet Manitoba has a different position regarding the extent of creditor protection available to RRSP proceeds.[30] In Saskatchewan the law is the same as it is in Ontario: RRSP money is not part of the deceased's estate and is unavailable to the estate's creditors.[31] In Manitoba, RRSP moneys do not form part of the deceased's estate but they are available to the estate's creditors.[32]

Prince Edward Island and British Columbia offer clear creditor protection by statute. Section 9 of Prince Edward Island's *Designation of Beneficiaries Under Benefit Plans Act*[33] reads as follows:

> 9. Where a beneficiary is designated, any benefit payable to the beneficiary is not, from the time of the happening of the event upon which it becomes payable, part of the estate of the participant, and is not subject to the claims of the creditors of the participant.

Section 49 (2) of British Columbia's *Law and Equity Act*[34] reads as follows:

> (2) If, in accordance with the terms of a registered plan, an annuitant designated a person to receive a benefit payable under the registered plan in the event of the annuitant's death,
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> …,
>
> (b) the person designated may enforce payment of the benefit, and
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> (c) the benefit is not part of the estate of the annuitant.

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[30] B.S. Corbin, "RRSPs: Partial Protection Against Creditors?" (2000) 20 E.T.P.J. 33.

[31] *Baltzan Estate v. Canada* [1990] 3 W.W.R. 374, 82 Sask. R. 280 (Surr. Ct.).

[32] *Clark Estate supra* note 10.

[33] R.S.P.E.I. 1988 c. D-9.

[34] R.S.B.C. 1996 c. 253.

The recent decision of the Supreme Court of Canada in *Bank of Nova Scotia v. Thibault*[35] emphasizes that not all RRSPs and RRIFs are similar. While this case may be interpreted narrowly based on relevant sections of Quebec legislation, it should come as a warning to consumers to look closely at the products they are purchasing if creditor protection is a concern. Mr. Thibault had purchased a self-directed RRSP that was marketed as exempt from seizure because it was held in a trust. However, as the Court noted, "exemption from seizure does not result from the mere intent of the parties."[36] Despite the fact that the terms of the RRSP were set out in a "Declaration of Trust", the manner in which the alleged trust operated did not adhere to the legislative requirements for protection from creditors. Specifically, the annuitant, Mr. Thibault, maintained control over his account; he did not "alienate" the capital that he deposited. Consequently, the funds in the RRSP were subject to seizure by his creditors. Thus in Quebec, the RRSP must be characterized as an annuity or trust to be protected from the hands of creditors.

The courts in Alberta, New Brunswick, Nova Scotia and Newfoundland have yet to consider this issue, although the Nova Scotia Supreme Court in *Bruhm v. Feindel*[37] did consider it indirectly in the context of executors and administrators compensation. In that case, the question of compensation turned on whether certain RRSP proceeds and a jointly held bank account were "received" by the executors in the administration of the estate. The designated beneficiary could enforce payment of the benefits upon the death of her husband as plan holder by virtue of section

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[35] [2004] 1 S.C.R. 758.
[36] *Ibid.* at para. 2.
[37] (1999) 175 N.S.R. (2d) 173, N.S.J. No. 57 (S.C. (T.D.)).

9 of the *Beneficiaries Designation Act*[38]. The Court concluded that the RRSP proceeds did not pass through the hands of the executors nor were they otherwise administered by them. In other words, the RRSP proceeds did not form part of the deceased's estate. Thus it is possible that a court in Nova Scotia considering this issue could conclude that RRSP proceeds are not available to an estate's creditors. What courts Alberta, New Brunswick and Newfoundland will do when faced with this issue is anybody's guess.

[38] R.S.N.S. 1989 c. 36.

MORAL CONSIDERATIONS UNDER PART V OF THE *SUCCESSION LAW REFORM ACT*

Cummings et al. v. Cummings[39]

In a judgment rendered January 15th, 2004, the Court of Appeal for Ontario affirmed the decision of Cullity J. at first instance that the consideration of a deceased person's moral obligations remains relevant under Part V of the *SLRA*.

The deceased in *Cummings* had two adult children, both dependants within the meaning of the *SLRA*, at the time of his death. The respondent on this appeal was the deceased's second wife. The deceased's son suffered from a progressively debilitating neuromuscular disease for which there was no known cure. In his will, the deceased directed that a testamentary trust in the amount of $125,000 be established to provide support payments in the amount of $600 per month, reducing to $400 per month when either child ceased to be a dependant. Cullity J. found that the net value of the estate, for the purposes of the dependants' relief application, was approximately $650,000. He held that the deceased had not adequately provided for the proper support of his dependant children by establishing the $125,000 testamentary trust. He concluded that the level of support should be set at $250,000, payable by way of lump sum to the deceased's ex-wife in trust to be applied to a maximum of $10,000 for his daughter's expenses for completing her Masters degree and the remaining amount to be held on trust to apply the income, and to the extent it is insufficient, the capital, for the care and welfare of the deceased's son during his lifetime.

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[39] (2004) 69 O.R. (3d) 398, 235 D.L.R. (4th) 474, aff'g (2003) 223 D.L.R. (4th) 732 [*Cummings* cited to O.R.].

In determining the allocation of the testator's estate for dependant's relief purposes, Cullity J. took into account not only the needs of the testator's children but also the moral obligations of the deceased towards his dependants.

> When judging whether a deceased has made adequate provision for the proper support of his or her dependants and, if not, what order should be made under the Act, a court must examine all the claims of all dependants, whether based on need or on legal or moral and ethical obligations. This is so by reason of the dictates of the common law and the provisions of sections 57 through 62 of the Act.[40]

Section 58(1) of the *SLRA* reads:

> 58. (1) Where a deceased, whether testate or intestate, has not made adequate provision for the proper support of his dependants or any of them, the court, on application, may order that such provision as it considers adequate be made out of the estate of the deceased for the proper support of the dependants or any of them.

Section 62(1) of the *SLRA* contains a list of factors that must be considered by a court in determining an application under section 58. Blair J.A., writing on behalf of the unanimous Court of Appeal stated "…the factors listed are a mélange of criteria based not only on needs and means but also on legal and moral or ethical claims".[41] The Court pointed out that many of the factors outlined in section 62(1) reinforce the notion that the moral obligations of the deceased cannot be ignored. The Court outlined the following examples of moral obligations that are found section 62(1) of the *SLRA*: (g) (the proximity and duration of the dependant's relationship with the deceased); (h) (contributions made by the dependant to the deceased's welfare); (i) (contributions by the dependant to the acquisition, maintenance and improvement of the deceased's property and business); (j) (contribution to the deceased's career potential); and (r)(ii) (the length of time the spouses cohabited). *Cummings* is the first appellate decision to deal with the issue of whether and to what extent moral or ethical obligations may be taken into account on

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[40] *Ibid.* at para. 27.

[41] *Ibid.* at para. 34.

a dependants' relief application since the *Dependants' Relief Act* was replaced by the *SLRA* in 1978. The Court notes that since 1978 there have been conflicting decisions in Ontario as to the role moral considerations play in these applications. In the Court's view, these conflicts have been resolved by the Supreme Court of Canada in *Tataryn v. Tataryn Estate*[42], a case out of the British Columbia courts. There, the Supreme Court held that a deceased's moral duty towards his or her dependants is a relevant consideration on a dependant's relief application, and that judges are not limited to conducting needs-based economic analysis in determining what disposition to make. The Court in *Cummings* saw no reason why the principles in *Tataryn* should not apply equally in Ontario, even though they were enunciated in the context of the British Columbia *Wills Variation Act*[43]. The language in that Act is somewhat different than that of the *SLRA*. *SLRA* section 58(1) allows a court to "order such provisions as it considers adequate" whereas section 2(1) of the *Wills Variation Act* permits a court to order what it considers "adequate, just and equitable in the circumstances". The Court in *Cummings* was not persuaded that the disparity in language between "adequate" and "adequate, just and equitable in the circumstances" was important. The Court pointed out that an Ontario court is mandated by the opening wording of section 62(1) of the *SLRA* to "consider all the circumstances of the application". McLachlin J. (as she then was) in *Tataryn* pointed out that the making of "adequate" provision and the ordering of what is "adequate, just and equitable" are "two sides of the same coin". The Court in *Cummings* concluded "… the disparities between the British

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[42] [1994] S.C.R. 807, 116 D.L.R. (4th) 193 [*Tataryn*].
[43] R.S.B.C. 1979, c. 435.

Columbia and Ontario statutes are not sufficiently telling to preclude the application of *Tataryn* in this province."[44]

The Court in *Cummings* also considered the argument in *Tataryn* that the *Wills Variation Act* must be interpreted through the "prism of modern values".

> …[T]wo sorts of norms are available and both must be addressed. The first are obligations which the law would impose on a person during his or her life were the question of provision for the claimant to arise. These might be described as legal obligations. The second type of norms are found in society's reasonable expectations of what a judicious person would do in the circumstances, by reference to contemporary community standards. These might be called moral obligations, following the language traditionally used by the courts. Together, these two norms provide a guide to what is "adequate, just and equitable" in the circumstances.[45]

The Court concluded that when examining all of the circumstances of an application for dependants' relief, a court must consider,

(a) what legal obligations would have been imposed on the deceased had the question of provision arisen during his lifetime; and

(b) what moral obligations arise between the deceased and his or her dependants as a result of society's expectations of what a judicious person would do in the circumstances.[46]

The Court ultimately decided that Cullity J. was correct in concluding that moral obligations continue to be relevant to applications under Part V of the *SLRA* in Ontario.

Cullity J. admitted that a needs-based approach to the application before him for dependants' relief might have been enough to dispose of this case, but he was compelled to go further.

> On a strictly needs-based approach, I might well be justified in ordering that the entirety of the net testamentary estate be transferred for the support of Paul and for the assets of the notional estate to be charged for their full value. I do not think this would be a correct disposition of the case. I

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[44] *Cummings supra* note 39 at para. 47.

[45] *Tataryn supra* note 42 at para. 28.

[46] *Cummings supra* note 39 at para. 50.

> believe that, apart from any residual value that is to be attributed to freedom of testamentary disposition, and the direction in section 62(1)(k) to consider the existence of a legal obligation to support another person, moral considerations continue to have a part to play in the analysis, although, if due consideration is given to the differences in the wording of the legislation in this province and that of British Columbia, they may not be given the same significance as in the courts of the latter.[47]

This passage opened the door for the Court of Appeal to settle the law on moral obligations under Part V of the *SLRA*. The Court of Appeal disagreed with the caveat that moral considerations are of less significance in Ontario than in British Columbia. Cullity J. made it easy for the Court of Appeal to address *Tataryn*, and ultimately to adopt it, as law in Ontario. As a result, although the language of the *SLRA* differs from that of B.C.'s *Wills Variation Act*, the law as regards moral obligations on dependants' relief applications is the same. An application for leave to appeal to the Supreme Court of Canada was denied without reasons on June 24, 2004.[48] Thus for now *Cummings* and the need to consider morality in dependants' relief applications is law in Ontario.

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[47] *Cummings supra* note 39 at para. 32.

[48] [2004] S.C.C.A. No. 93.

SINGLE PURPOSE CORPORATIONS

On June 23rd, 2004, the Canada Revenue Agency ("CRA") signalled the virtual end of the ownership by Canadians of U.S. vacation residences in corporate form. This mechanism has been one of the ownership options used by Canadians to avoid becoming subject to U.S. estate taxes on death, which are calculated for non-residents of the U.S. based upon the value of the U.S. property. CRA has announced that it will abandon its policy, first described in 1980, of not assessing shareholder benefits under subsection 15(1) of the *Income Tax Act*[49], where a corporation owns U.S. based real property used personally by the shareholder or the shareholder's family.

U.S. Estate Taxes

The U.S. levies significant estate taxes on its citizens, green card holders and long term permanent residents on the fair market value of their worldwide property on death. Canadians who maintain their connections to Canada are generally subject to U.S. estate tax only on the fair market value of personally-owned assets that are situate in the U.S. on death. Real estate located in the U.S. is a prime example of property having a U.S. situs.

When Canada abolished its estate taxes in 1972, it also terminated its estate tax convention with the U.S. Although the U.S. tax regime provides various deductions in calculating the taxable estate of an individual, for Canadians these are pro-rated by comparing the value of the U.S. situs assets against the Canadian's worldwide assets. The availability and amount of the deductions are governed by amendments to the Canada-United States Income Tax Convention (the

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[49] R.S.C. 1985, c. 1 [*ITA*].

"Convention") that came into effect on November 9, 1995. These amendments allow Canadians on a pro-rated basis to access both a unified credit, and a marital credit, if applicable. As part of a proposed temporary phase-out of U.S. estate taxes the deduction amounts for 2004 for each of these credits has increased to $1,500,000 U.S. before proration. CRA has determined that with these developments Canadian residents generally are no longer confronted with U.S. estate tax problems. This will not be the case, however, for Canadians with valuable U.S. properties, representing only a percentage of their overall net worth.

IRS Position

Historically, many Canadians with personal real estate in Florida, Arizona or Hawaii have used a Canadian single purpose corporation to effect the purchase. For U.S. estate tax purposes shares of a Canadian corporation are not considered to have a U.S. situs, and accordingly, do not form part of the U.S. taxable estate on the death of the shareholder. It is noteworthy that the U.S. Internal Revenue Service ("IRS") has maintained that it has the ability to look through situations such as single purpose corporations, particularly where a corporation is only a nominee or the corporate form has not been honoured in practice. The IRS has been active in assessing values where individuals fund the ownership and maintenance of property they use. In recent U.S. cases dealing with rights retained in a family limited partnership the Fifth Circuit court has given mixed messages as to when the retention of rights leads to an estate tax inclusion of the entire property (*Strangi* v. *Comr*. 293 F. 3d 279, 2002), or only a portion (*Kimbell*, May 20, 2004).

Old CRA Position

When a corporation provides a personal benefit to a shareholder, under the *ITA* there is an imputed benefit for tax purposes to the shareholder. In order to alleviate such an imputed benefit or the need for the corporation to charge rent to the shareholder for the use of corporate-owned

U.S. real property, the CRA introduced administrative leniency. There would be no imputed benefit if the corporation adhered to a single purpose of acquiring and holding property for the personal use and enjoyment of the shareholder. Over the years CRA has narrowed its policy by adding various conditions to ensure that only the most straight forward situations would qualify where the shareholder, the corporation and the property are completely interwoven.

CRA Changed Position

CRA Income Tax Technical News No. 31 indicates that, subject to some grandfathering, CRA is ending its administrative position. Canadians will no longer wish to purchase U.S. personal real estate through single purpose corporations, because there will be the disadvantageous Canadian implications of a taxable benefit arising from the use of the property.

There is a grandfathering provision that will maintain CRA's old administrative policy for an existing single purpose corporation with an existing property as of June 22, 2004. The relief will continue until the disposition of the existing property or until there is a disposition of the shares of the corporation by sale or on death. The transitional relief will continue on the death of the shareholder if the shares are passed to the shareholder's spouse or common law partner.

Alternative Planning

The use of single purpose corporations has been only one viable form of estate planning for the ownership of U.S. personal use real property. In fact, their popularity has been declining, as the Canadian capital gains rate has been reducing significantly in recent years, in fact, below the applicable corporate capital gains rates in many states, such as Florida. Some alternative planning whose popularity will undoubtedly rise include the use of non-recourse mortgages, family limited partnerships, trusts and various joint ownership plans.

Credit Availability in Canada

When U.S. estate tax is exigible, it is generally irrespective of whether there are gains on the property, or the extent of the Canadian capital gains tax on death. Such U.S. estate tax does not necessarily result in an extra level of taxation where the property has appreciated significantly in value. For U.S. purposes the payment of estate taxes results in a cost base adjustment to fair market value, reducing future capital gains taxation. For Canadian purposes the payment of U.S. estate tax may result in a credit against capital gains taxes arising on the death of the owner in respect of the property. Paragraph 6 of Article XXIXB of the Convention provides generally that a resident of Canada whose worldwide gross estate exceeds $1,200,000 U.S. is entitled to deduct from Canadian tax on death in respect of U.S. real estate the applicable U.S. estate or inheritance taxes. It is possible for the full amount of U.S. estate tax to be used as a credit against Canadian taxes where an appreciable part of the asset value is attributable to property or exchange gains.

AFFILIATED PERSONS RULES AND TRUSTS

Section 251.1 of the *Income Tax Act* sets out rules for determining when persons are affiliated with one another, which is relevant to a number of provisions of the *Act*, most notably those restricting the realization of losses on certain transfers. The existing affiliated persons rules in section 251.1 of the *ITA* do not currently deal with trusts. Draft legislation released September 16th regarding the 2004 federal budget proposals aims to expand section 251.1 to specifically deal with trusts. New paragraphs 251.1(1)(g) and (h), in tandem with the new definitions "beneficiary", "contributor", "majority interest beneficiary" and "majority interest group of beneficiaries" in subsection 251.1(3), and new interpreting rules in subparagraphs 251(4)(c)(i) to (v) expand the existing affiliated persons rules to expressly apply to trusts. This new provision will apply at any time after March 22nd, 2004.

New paragraph 251.1(1)(g) sets out certain circumstances where a person and a trust are affiliated. This paragraph applies if a person is a majority interest beneficiary or is affiliated with a majority interest beneficiary of the trust otherwise than solely because of paragraph (g) itself. A "majority interest beneficiary" is a person who is entitled to more than 50% of the income or capital of the trust.

New paragraph 251.1(1)(h) sets the out circumstances where two trusts are affiliated. This paragraph applies where two conditions are met:

1. a contributor to one of the trusts is affiliated with a contributor to the other trust; and
2. a majority interest beneficiary of one of the trusts must be affiliated with either a majority interest beneficiary or each member of a majority interest group of beneficiaries of the other trust; or each member of a majority interest group of beneficiaries of each trust is affiliated with at least one member of a majority interest group of beneficiaries of the other trust.

A "contributor" is a person who, at any time, has contributed property or transferred funds to the trust on a non-arm's length basis or for inadequate consideration. A group of persons is a "majority interest group of beneficiaries" of a trust at any time where two conditions are met:

1. each member of the group is a beneficiary under the trust at that time such that if one member held all the interests as a beneficiary of the members of the group that person would be a majority interest beneficiary of the trust; and
2. if any member were not a member of the group, then the former condition would not be met.

For the purposes of this definition, only persons acting in concert are considered to be a group.

Subsection 251.1(4) contains interpretive rules that apply for the purposes of section 251.1. New paragraph 251.1(4)(c) contains five new rules applicable in determining when a person is affiliated with a trust.

Under subparagraph 251.1(4)(c)(i), if the amount of income or capital that a person may receive as a beneficiary under the trust depends on the exercise or non-exercise of a discretionary power, this subparagraph deems the power to have been fully exercised or not exercised, as the case may be. The effect of this rule is to maximize, for the purposes of determining whether a person is affiliated with a trust, the amount of income or capital of the trust a person may receive as a result of a discretionary power.

Under subparagraph 251.1(4)(c)(ii), a person who is a beneficiary under a trust will not be considered, in determining whether a person is affiliated with a trust, to deal on a non-arm's length basis with the trust simply because the person is a beneficiary under the trust.

Subparagraph 251.1(4)(c)(iii) clarifies that, notwithstanding subsection 104(1), in determining whether a person is affiliated with a trust, a reference to a trust does not include a reference to the trustee or other persons who own or control the trust property.

Under subparagraph 251.1(4)(c)(iv), a trust is not a majority interest beneficiary of another trust unless the first trust has an interest as a beneficiary in the income or capital of the other trust. As a result, a trust that has no interest as a beneficiary in either the income or capital of another trust is in no case a majority interest beneficiary of the other trust, even if the first trust is affiliated with one or more persons who together have majority interests in either the income or capital of the other trust.

Subparagraph 251.1(4)(c)(v) expands, for the purposes of determining whether a contributor to one trust is affiliated with a contributor to another trust, the categories of individuals who are considered to be affiliated with one another. As a result, persons who are connected by blood relationship, common-law partnership, or adoption will also be considered to be affiliated with one another for these purposes.