

# Taxation at Death

## Special Rules You Need to Know

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**Grace Chow and Matthew Cho**  
**Cadesky Tax**

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# Payment and Filing Extensions

- The terminal return due date of a deceased taxpayer may be extended depending on when the taxpayer died.
- If the taxpayer passes away after October of the year of death but before the regular filing due date for the year, the deadline is later of regular due date or six months after death.
- For June 15 filers, deadline remains June 15 unless the death occurs between December 16 to 31.
- For April 30 filers, deadline remains April 30 unless death occurs between November and December.
- The policy objective is to always allow at least 6 months to file the terminal return.

# Payment and Filing Extensions

- The filing due date for the deceased's spouse/common-law partner's return for the year of death is the same as the deceased.
- If a “tainted” spousal trust was created then the terminal return is due 18 months after death, but spouse/common-law partner does not get this.
  - If spouse, for whatever reasons, decides to give up her entitlement under the trust, the trust will no longer be a spousal trust and no 18 months extension.

# Payment and Filing Extensions

- The balance owing on the terminal return is due 6 months from death if the person dies between October of the year and May of next year.
- Presumably same policy objective as the filing deadline, HOWEVER:
  - This does **NOT** apply to the spouse/common-law partner!!!!!!!!!!!!
- No equivalent for “tainted” spousal trust.

# Rights or Things

- The legal representative of a deceased taxpayer may elect to file a separate tax return for the deceased and report the income from “rights or things”.
- Rights or things typically includes amounts accrued to the deceased but not yet received, like bonus, or dividends declared but not yet received.
- This allows multiplication of certain tax credits (e.g., basic personal amount & age credit) and saves more tax for the deceased taxpayer.
- Election must be filed no later than the later of:
  - one year after date of death; and
  - 90 days after the date of the notice of assessment of the terminal return.

# Rights or Things

- However, if the rights or things are distributed to the beneficiaries before the election deadline then the amounts are included in the beneficiaries' income and not the deceased nor on a separate return, per ss. 70(3).
- Note the reference is to election deadline not when the election is filed. So if the election is filed a month after death, but rights or things are distributed in say 6 months after death, the income is to be reported by the beneficiaries.

# 15(2) and Repayment by Estate

- A shareholder who had a ss. 15(2) income inclusion passed away and the estate repaid the debt. Does par. 20(1)(j) apply and who gets the deduction?
- An argument may be made to deny a deduction as the estate is not the same shareholder that took out the loan.
- CRA's position is that:
  - Estate can get the deduction not the deceased.
  - If loan was repaid by the estate before ss. 15(2) can apply (e.g., the 1 year rule), then no ss. 15(2).
  - No deduction for anyone if beneficiary repays the loan.

# Debt Forgiveness

- Paragraph 80(2)(a) provides an exception for debt extinguished by way of a bequest or inheritance
- No debt forgiveness to debtor if debt forgiven at death as provided under the will



# Debt Forgiveness

- Capital loss to deceased only if debt acquired for the purpose of gaining or producing income (interest bearing or also shareholder of corporation for corporate debt) [ CRA Views 2012-0442951C6, STEP CRA Roundtable – June 2012 –Question 3 – Section 40(2)(g)(ii), 80, 248(1)]
- Can apply to prescribed loan for income splitting
- For corporate debt, evaluate use of capital loss vs. extraction of funds from corporation

# Capital Losses

- Subsection 111(2) provides a special rule for capital losses
- Any capital losses realized in the year of death or carried forward from a previous years are applied to capital gains for the year of death
- Amount is reduced by any capital gains exemption claimed
- 50% of remaining unused capital losses (net capital losses) may be applied against any other income for the year of death and the immediately preceding year

# Capital Losses

- Superficial loss rule under section 54 does not apply because of exception under paragraph (c) for deemed disposition under section 70
- Normal capital loss carryover provision still applies in respect of capital loss realized in the year of death

# Death Benefit

- CPP death benefit received by an estate is income of the estate, not the deceased.
- However, the estate may be able to distribute the amount to a beneficiary and take a deduction.
- Or they can distribute and file ss. 104(13.1) election to keep it taxed in the estate (note ss. 104(13.3)).

# Death Benefit

- Unlike CPP death benefit, other “death benefit” received are taxable to the recipient per subpar. 56(1)(a)(iii).
- Death benefit is a defined term in ss. 248(1) and is an amount paid in relation to services provided by an employee or former-employee prior to death.
- However, the first \$10,000 is not taxable and it is on the aggregated death benefit amounts received.

# Death Benefit

- More than one person can receive death benefit in respect of the same employee, the \$10,000 in this case would be allocated based on formula.

$$\begin{array}{r} \$10,000 \text{ less amounts} \\ \text{received by surviving} \\ \text{spouse spouse/partner} \end{array} \times \frac{\begin{array}{r} \text{Amounts received} \\ \text{by the taxpayer} \end{array}}{\begin{array}{r} \text{Total amounts received by} \\ \text{people who are not surviving} \\ \text{spouse/partner} \end{array}}$$

- Formula implies a priority to spouses/partners.

# Death Benefit

- Any “unused” \$10,000 room may be “carried forward” to a future year if death benefits are received in more than one year.
- If more than one person received death benefit over several years, prior year returns may need to be amended to reflect the final allocation.
- Death benefit from a pension plan is NOT death benefit but considered pension income.

# Death Benefit – Example 1

- JT died today.
- ST (the spouse) and CF (the partner) each receives a death benefit of \$10,000 in respect of JT's death in the current year in recognition for his services as a drama teacher in the past.
- The \$10,000 tax exempt amount is allocated evenly at \$5,000 per person.
- On the tax returns for ST and CF, each reports \$5,000 of income from death benefit.
- In the next year, ST receives a further \$10,000 of death benefit in respect of JT's services as a teacher. Then the tax returns for both ST and CF for the current year need to be revised to change the allocation of the exempt amounts to \$3,334 to CF and \$6,666 to ST.



# Death Benefit – Example 2

- JT died today.
- ST, the spouse, received \$10,000 in respect of JT's death in recognition for his services as a drama teacher in the past. GB, a close friend of JT, also received \$10,000.
- GB gets no allocation based on the formula.

# Capital Gains Exemption

- Paragraph 110.6(14)(g) provides that the 90% test is met if the condition applies at any time within the 12-month period immediately preceding the death of an individual
- Other conditions including the 24-month holding period and 50% test still need to be met
- CGE can be claimed as long as company meets the 90% test once a year

# Capital Gains Exemption

- No AMT at death under section 127.55 paragraph (c)
- Unused AMT credits can all be applied in the year of death
- Need to consider if there is CNIL or ABIL claimed that would be taxable before CGE can be claimed

# Qualified Farm or Fishing Property

- CGE of \$1,000,000 under subsection 110.6(2.2), rollover from deceased to children under subsections 70(9.01) and 70(9.21) and rollover from trust to settlor's children under subsections 70(9.11) and 70(9.21)

# Qualified Farm or Fishing Property

- QFFP defined under subsection 110.6(1) includes real or immovable property or fishing vessel used principally in the course of carrying on the business of farming or fishing in Canada, shares of the capital stock of a family farm or fishing corporation, interest in a family farm or fishing partnership and Class 14.1 asset

# Qualified Farm or Fishing Property

- Extended meaning for child under subsection 70(10) to include a grandchild, great grandchild, step-child or any person under the age of 19, was wholly dependent on the deceased who had custody and control of the person

# Acquisition of Control

- When an individual dies holding shares of a company, the shares are usually transferred to the estate to be administered by the trustee(s).
- For many purposes of the Act, the trustee(s) is viewed to be controlling the shares.
- Technically, an acquisition of control (“AOC”) could arise when the controlling shares are transferred from the deceased to the estate and again from the estate to the beneficiary.
- Change in trustee(s) could result in an acquisition.

# Acquisition of Control

- Special rules are included in ss. 256(7) to deem control to be acquired (or not):
  - clause 256(7)(a)(i)(C) – no AOC when estate acquires shares from the deceased;
  - clause 256(7)(a)(i)(D) – no AOC when shares are distributed to beneficiary of an estate provided the estate acquired the shares from the deceased and the beneficiary is related to the deceased;
  - par. 256(7)(h) – AOC (parent and subs) if a trust controls, or member of a group that controls a corporation, is subject to a loss restriction event;
  - par. 256(7)(i) – no AOC on change in trustee if the change is not part of a series that lead to a change in beneficial ownership, and the income/capital entitlement of the trust is not discretionary.



# Spousal Rollover

- By default, properties transferred to spouse on death is tax deferred.
- Can elect out of rollover.
- Useful when the deceased has capital losses.
- However, care must be given to avoid election on properties that are subject to spousal attribution rule.

# Spousal Rollover - Example

- Wife gifted Amazon shares to spouse, PT, a long time ago.
- PT had capital loss from Bre-X shares.
- PT died and wife inherited the Amazon shares as per the will.
- PT's accountant elected out of spousal rollover on the Amazon shares, claimed the Bre-X loss against the Amazon gain.

# Spousal Rollover - Example

- What they hope to happen:
  - Loss offsets the gain, wife gets a step-up on the Amazon shares, accountants get paid.
- What will probably happen:
  - Tax authority does not catch it; tax avoidance achieved by luck.
- What should happen:
  - CRA reassesses the gain in wife's hand, PT's capital loss not used and accountant gets sued.

# Spousal Rollover

- Election under ss. 70(6.2) is on a property-by-property basis.
- By property it means a “whole property” and not part of, or a fraction of a property.
- Election is not available on fractional share or a portion of a partnership interest that is not denominated in units.

# Spousal Rollover

- LLC interests may pose a mismatch issue.
- LLC interests are sometimes not expressed in shares or units.
- On death, rollover to spouse in Canada but U.S. could have estate tax.
- If rollover, no credit under Canada-U.S. treaty.
- Cannot partially elect out of rollover if LLC interest is not expressed in shares or units.
- Can ss. 93.2 save this situation? What if the result has a fraction (e.g., 20.17718 shares)?

# Depreciable Property

- Subsection 70(13) provides that certain adjustments previously made to the capital cost of depreciable property under subsection 13(7) do not apply
- Paragraph 13(7)(e) does not apply to adjust the capital cost of the property to the estate for the non-taxable portion of capital gain

# Depreciable Property

- Designation of ordering under subsection 70(14) – may be meaningful if property may be rolled over (e.g. spousal rollover)
- Subsection 13(21.1) applies if there is a loss on building and gain on land

# Depreciable Property

- Where depreciable property disposed of at a loss at death, the estate/beneficiary is deemed under paragraph 70(5)(c) to have acquired the property at the capital cost to the deceased and to have claimed CCA equal to the difference between the capital cost and the FMV



# Depreciable Property

## Example

### Rental property

- FMV \$200,000
- Capital cost \$300,000
- UCC \$250,000

### Deceased

- Terminal Loss \$50,000

# Depreciable Property

## Example

### Estate

- Deemed Capital cost \$300,000
- UCC \$200,000
- Deemed 20(1)(a) deduction \$100,000

### Future sale at \$350,000

- Capital Gain \$50,000
- Recapture \$100,000

# Principal Residence

- Whether or not to claim the principal residence exemption or rollover to spouse
- Paragraph 40(4)(a) provides for deemed ownership so property may qualify as the beneficiary spouse's principal residence
- Subparagraph 40(4)(b)(i) requires designation by the legal representative of the deceased spouse

# Principal Residence

- Spousal Trust is one of the trusts that may claim the principal residence exemption under paragraph (c.1) of the definition of principal residence under section 54

# Tainting and Untainting Spousal Trust

- Payment of non-qualifying testamentary debts (e.g. taxes payable on terminal tax return) may taint a spousal trust
- Qualifying debts are:
  - any estate, legacy, succession, or inheritance duty payable in consequence of the death of the taxpayer or the spouse or common-law partner who is a beneficiary under the trust, in respect of its property (e.g. mortgage on a property) or the trust's interest in it;
  - any income or profits tax payable by the trust in respect of its income (but not tax payable by deceased on terminal return) .

# Tainting and Untainting Spousal Trust

- Untainting may be possible under subsection 70(7) if tainting caused by payment of non-qualifying testamentary debts
- Designate certain assets to be disposed of at FMV to satisfy the payment of debts
- Remaining assets can then be rolled over

# Tainting and Untainting Spousal Trust

- Example

List of assets of deceased:

- Cash \$20,000
- 5,000 Bank of Nova Scotia shares FMV \$50 per share; ACB \$25 per share
- Rental property FMV \$500,000 ACB \$200,000

# Tainting and Untainting Spousal Trust

- Example

Liabilities of deceased:

- Taxes payable (assuming rollover) \$20,000
- Mortgage on rental property \$100,000
- Funeral expenses \$10,000

Only mortgage is qualifying debt

Total non-qualifying debts of \$30,000



# Tainting and Untainting Spousal Trust

- Example

Assume tax rate of 50%

Designation:

- Cash \$20,000
- 265 Bank of Nova Scotia shares \$13,250
- Total = \$33,250

Additional capital gain 265 shares x \$25 = \$6,625

Additional tax = \$3,312.50

# Tainting and Untainting Spousal Trust

- Designation will create capital gain and additional taxes
- Circular calculation
- Election must be filed with terminal return
- Extended due date to 18 months after death under paragraph 70(7)(a)
- Deemed disposition at death of spouse still applies to assets disposed of at FMV to spousal trust

# Instalments

- Subsection 156.1(3) relieves tax instalments requirements for an individual that would otherwise be required on or after the day the individual dies.