ALTER EGO, JOINT CONJUGAL, AND SELF-BENEFIT TRUSTS REVISITED: SOME TROUBLING TAX ISSUES AND A SEARCH FOR BETTER ALTERNATIVES*

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1. Introduction

In 2001, a number of new *inter vivos* trusts were introduced in the *Income Tax Act*,[1] including the "*alter ego* trust,"[2] the "joint spousal or common-law partner trust",[3] the so-called self-benefit trust,[4] and the "qualifying disposition" trust.[5] The new statutory provisions were introduced largely in response to a proliferation of trusts that were appearing in the context of asset protection and probate planning or as an alternative to a power of attorney.[6] Now that we have had some time to analyze these new trusts, it is perhaps prudent to compare their use with other trust arrangements. The following discussion undertakes this task and poses two questions: first, what tax traps do these new trusts present for the unwary; and, second, will more traditional trust arrangements offer a better overall tax result?

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1. R.S.C. 1985, c. 1 (5th Supp.), as amended (the "Act"). Unless otherwise stated, statutory references in this article are to the Act.
2. Defined in s. 248(1).
3. Defined in s. 248(1).
4. Section 73(1.02)(*b*)(ii). This name was coined to describe this type of trust in Cindy L. Rajan and Catherine A. Brown, "Personal Trusts 2000: Taxation and Planning in the New Millennium", in *Report of Proceedings of the Fifty-Second Tax Conference*, 2000 Conference Report (Toronto: Canadian Tax Foundation, 2001), 28:1-55, at p. 28:4.
5. Section 107.4.
6. The initial concern of taxpayers and their advisers in establishing these trusts was whether a taxable disposition would occur on a transfer to the trust. The Canada

Before examining the specific tax provisions, it is useful to outline some of the common tax and non-tax reasons for establishing an *inter vivos* trust in Canada.[7] These will serve as a reference point as the various trust arrangements are considered.

The typical income tax reasons for establishing an *inter vivos* trust are:

- income splitting,
- avoiding a deemed disposition on death, and
- benefiting from reduced provincial tax rates.

Common non-tax reasons for establishing an *inter vivos* trust include

- potential probate savings;
- confidentiality;
- centralization of property and continuity of management;
- asset management without using a power of attorney;
- protection from creditors; and
- protection from spousal claims under legislation such as Ontario's *Family Law Act*,[8] and dependant's claims under legislation such as Ontario's *Succession Law Reform Act*[9] or British Columbia's *Wills Variation Act*.[10]

A number of trust arrangements are available for achieving some or all of these objectives. Many of the objectives can be achieved through

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Revenue Agency (CRA) originally responded with guidelines for what it considered a protective trust-a trust to which transfers could be made without giving rise to a taxable disposition. See *Income Tax Technical News*, No. 7, February 21, 1996. See also CRA document No. 9830105, February 26, 1999. Although the concept of a protective trust was not carried forward into the new statutory provisions, three of the four new rollovers apply to assets transferred to a trust for the settlor's benefit: the *alter ego* trust, the trust to which s. 73(1.01) applies, and the trust to which s. 107.4(1) applies. For a fuller discussion of the history of these trusts, see Rajan and Brown, *op. cit.*, footnote 4.

7. The following discussion assumes that the trust will be resident in Canada. This is generally achieved by ensuring that the majority of trustees reside in Canada or decision-making power is exercised in Canada. See *Thibodeau v. Canada* (1978), 3 E.T.R. 168, [1978] C.T.C. 539, 78 D.T.C. 6376 (F.C.T.D.). Non-resident trusts are subject to the provisions of s. 94 and proposed legislation, including Canada, Department of Finance, Notice of Ways and Means Motion To Amend the *Income Tax Act*, introduced on October 30, 2003 and accompanying *Legislative Proposals Relating to the Income Tax Act: Taxation of Non-Resident Trusts and Foreign Investment Entities* (Ottawa: Department of Finance, October 2003).
8. R.S.O. 1990, c. F.3, as amended.
9. R.S.O. 1990, c. S.26, as amended.
10. R.S.B.C. 1996, c. 490, as amended.

a transfer to a trust on a tax-deferred basis. For example, capital property can be transferred on a tax-deferred basis to an *alter ego* trust or a self-benefit trust; property that is not capital property can be transferred to a trust that is the result of a qualifying disposition[11] or to a bare trust[12] without a disposition. As this article makes evident, the benefit of tax deferral may not justify the potential tax costs associated with these trust arrangements or yield the best overall tax result. Where this is the case, the use of an alternative trust arrangement, such as a revocable trust, might be considered. These matters are discussed below.

2. *Alter Ego* Trusts

The *alter ego* trust is probably the best known of the new trusts. An *alter ego* trust is an *inter vivos* trust created by an individual who is at least 65 years of age. In addition,

- the individual who creates the *alter ego* trust must be entitled to all of the income of the trust that arises before the individual's death; and
- no other person may receive or obtain the use of any of the income or capital of the trust before the individual's death.[13]

The obvious use of an *alter ego* trust is for asset management in the case of personal incapacity. Other non-tax reasons to use an *alter ego* trust include those set out above for *inter vivos* trusts generally — for example, potential probate savings, protection from creditors, and avoidance of spousal and dependant relief claims.[14]

As stated, the much-touted tax advantage of such a trust is that property can be transferred to it on a tax-deferred basis. It may also be

11. "Qualifying disposition" is defined in s. 107.4(1). In order to achieve a rollover to the trust, no change in beneficial ownership can occur. See the discussion in the text accompanying footnote 47.
12. See the discussion under the heading "Bare Trusts", *infra*. For the purposes of s. 104(1), with limited exceptions, a bare trust does not "include an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property".
13. An *alter ego* trust is defined in s. 248(1) as a trust to which s. 104(4)(*a*) would apply if that paragraph were read without reference to s. 104(4)(*a*)(iii) and cls. 104(4)(*a*)(1v)(B) and (C). Thus, in addition to the listed conditions, the taxpayer must have created the trust after 1999; and at the time of the transfer to the trust, both the taxpayer and the trust must be resident in Canada.
14. See, for example, *Stone (Public Trustee of) v. Stone Estate* (1994), 4 E.T.R. (2d) 165, [1994] 8 W.W.R. 5, 20 Alta. L.R. (3d) 31 (Q.B.), affd [1998] 3 W.W.R. 598, 160 W.A.C. 138 *sub nom. Stone v. Stone Estate*, 54 Alta. L.R. (3d) 225 (C.A.); and *Stone v. Stone* (2001), 203 D.L.R. (4th) 257, 55 O.R. (3d) 491, 39 E.T.R. (2d) 292 (C.A.).

possible to take advantage of lower provincial tax rates if the settlor does not hold a capital interest in the trust or have control over the trust property such that the attribution provisions in s. 75(2) of the Act apply.[15] These provincial tax savings are achieved by selecting a trustee in a province with low tax rates (for example, Alberta) and then making an election under s. 104(13.1) for income that is otherwise payable to the beneficiary to be taxed in the trust instead.[16] The trust income will then be taxable in the province in which the trust (trustee) resides (and in which management and control is exercised) at that province's applicable rate.[17] Alternatively, the trust could receive capital amounts — for example, proceeds received on a redemption of shares — that would not be "payable" to a beneficiary and would therefore be taxed in the trust without the need for an election.

Provincial tax savings can also be achieved by transferring capital property with an unrealized gain to an *alter ego* trust that is resident in a province with a lower tax rate, in anticipation of the sale of the property. If the trust sells the property and the capital gain is not attributed to the transferor/beneficiary under s. 75(2) or payable to the beneficiary under the terms of the trust,[18] the gain will be taxed in the trust at the applicable federal and provincial tax rates.[19] If such a transfer is anticipated, the taxpayer may also want to consider appropriate non-tax reasons for establishing the trust — for example, family succession planning — to avoid the potential application of the general anti-avoidance rule (GAAR).[20]

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15. It is important that s. 75(2) not apply to the trust. If s. 75(2) applies, the trust income, losses, taxable capital gains, and allowable capital losses are attributable to the settlor. This will preclude the ability to tax income or gains in the trust using the election in s. 104(13.1) or (13.2) and thus the potential advantage of lower provincial tax rates. Section 75(2) will apply if trust property is held on condition that it or property substituted for it may revert to the person from whom the property was received, or pass to persons to be determined by the person at a time subsequent to the creation of the trust, or that during the person's lifetime the property cannot be disposed of except with the person's consent or in accordance with the person's direction.
16. Residents of Quebec should be cautious about making a s. 104(13.1) election. Special provisions apply when a Quebec resident sets up a non-Quebec trust and a s. 104(13.1) election is made. See ss. 671.5 to 671.10 of the Quebec *Taxation Act*, R.S.Q., c. 1-3.
17. See footnote 7, *supra*.
18. By virtue of s. 108(3), capital gains realized by an *alter ego* trust need not be paid out to the beneficiaries.
19. Even if the gain is payable to the beneficiary, an election can be filed under s. 104(13.2) to have the gain taxed in the trust.
20. See s. 245(1) and footnote 61, *infra*.

The use of an *alter ego* trust is not, however, without a tax cost. Consider the following:

- If assets are transferred to an *alter ego* trust, the 21-year deemed disposition rule is avoided while the settlor is alive; however, there is a deemed disposition of all the trust assets at fair market value on the settlor's death.[21] Although such a disposition would also occur if the assets were held personally, assuming a spousal rollover is not available, there are two additional consequences that should be considered. First, the deemed proceeds on the disposition of these assets will be taxed to the trust at *inter vivos* tax rates — that is, at the top marginal rate — and the benefit of graduated tax rates may be lost. Second, these trust assets are carved out of the deceased's estate and the gains or losses segregated from those realized on the deemed disposition on death under s. 70(5). This separation of gains or losses may result in greater overall tax liability on death, as the use of capital losses, if any, realized on the disposition of assets in the year of death will not be available to reduce gains realized in the *alter ego* trust. The reverse is, of course, also true. Any losses realized in the *alter ego* trust cannot be used to offset gains realized in the terminal year.
- *Alter ego* trusts are not able to benefit from the $500,000 capital gains deduction for shares held in a "qualified small business corporation" (QSBC)[22] or for "qualified farm property" (QFP).[23] Accordingly, a settlor who wishes to transfer such assets to an *alter ego* trust should consider whether he or she has made maximum use of the QSBC or QFP deduction prior to the transfer, recognizing that any future appreciation will lose the benefit of the deduction.[24]
- The deemed disposition of assets in the trust on the settlor's death precludes a rollover to a spouse or common-law partner or to a

21. Section 104(4)(*a*.4). However, the trust assets escape the 21-year deemed disposition where the settlor is alive. See the definition of "trust" in s. 108(1) and in particular para. (*g*). An *alter ego* trust may also elect under s. 104(4)(*a*)(ii.1) to avoid the deemed disposition on death and instead remain subject to the regime that applies to other trusts. If this election is made, the first deemed disposition date for the trust will be the 21st anniversary of the date the trust was established, unless all interests in the trust have vested indefeasibly. (See *infra*, footnote 67.)
22. See the definition of "qualified small business corporation shares" in s. 110.6(1).
23. See the definition of "qualified farm property" in s. 110.6(1).
24. One way to avoid the loss of the capital gains deduction is to add a power to encroach on the capital on behalf of the settlor. This, unfortunately, also invites the application of the attribution rules in s. 75(2) and, to the extent that encroachment is possible, may limit the benefit of protection against creditors.

testamentary trust for either. It also precludes a rollover of farm property to a child, including land and depreciable property, shares of a family farm corporation, or an interest in a family farm partnership.[25]

- Losses incurred in the *alter ego* trust belong to the trust for tax purposes and therefore cannot be carried back and used against gains or income of the deceased in the terminal year.[26]
- The Canada Revenue Agency (CRA) has opined that assets transferred from an *alter ego* trust, being assets of an *inter vivos* trust, cannot form part of a testamentary trust.[27] Thus, taxable income generated by these assets remaining in the trust following the death of the settlor will be denied the benefit of progressive tax rates and will continue to be taxed at the top marginal rate applicable to *inter vivos* trusts.
- The benefits of charitable giving through an *alter ego* trust are more limited than those available through a direct gift by will. Specifically, the ceiling for a gift by will is 100% of the donor's income in the year of death and the year preceding death.[28] In contrast, the ceiling for a gift structured as a charitable remainder trust is 75% of the donor's income for the year.[29] Depending on the terms of the trust, the transfer of property from the *alter ego* trust to the charity may also be treated as a charitable gift made by the trust, in which case the tax credit would go to the trust,[30] or as a distribution in satisfaction of the charity's capital interest in the trust, which would not result in a charitable tax credit to the trust.[31]

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25. Section 70(9) and (9.2).
26. Section 164(6).
27. CRA document No. 2001-0079285, November 2, 2001.
28. See s. 118.1(5) and (4).
29. In order to qualify as a charitable remainder trust, four key criteria must be met:
    1. The terms of the trust must not provide for a power of encroachment.
    2. The trust must provide the charity with a remainder interest in the trust that vests at the time the property is transferred to the trust.
    3. The trust must be irrevocable.
    4. The transfer of property to the trust must be voluntary and without expectation of benefit to the settlor from the donee charity.

    See, generally, *Interpretation Bulletin* IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust", November 29, 1991.
30. Section 118.1(3). The tax credit will accrue to the trust only if the gift is made in the year.
31. See CRA document No. 9918215, December 1, 1999.

Are there better alternatives to the use of an *alter ego* trust? This will depend on the taxpayer's primary objective. If the objective is, for example, probate savings or that the trust serve as an alternative to the grant of a power of attorney, the use of a self-benefit trust[32] or a trust that is the result of a qualifying disposition under s. 107.4(1) might be considered. As will be discussed, each option provides unique advantages.

3. Self-Benefit Trusts

"Self-benefit trust" is not defined in the Act. This label refers to an *inter vivos* trust to which capital property can be transferred by an individual on a tax-deferred basis under s. 73(1), in much the same way as a transfer to an *alter ego* trust, but which does not technically qualify as an *alter ego* trust. The main differences are that the settlor need not be 65 years of age or older and, immediately after the transfer, no person other than the settlor may hold a right (as determined under s. 104(1.1)) under the trust. In accordance with the rules in s. 73(1.01) and (1.02), for a trust to qualify for this rollover, the following conditions must be satisfied:[33]

- the terms of the trust are such that, during the settlor's lifetime, only the settlor is entitled to receive or use the income or capital of the trust arising before his or her death;
- the property transfer does not result in a change in beneficial ownership of the property; and
- after the transfer, no person other than the settlor has an absolute or contingent right to any of the trust property.[34]

Provided that the above conditions are satisfied, an individual, regardless of age, can transfer property to a self-benefit trust on a tax-deferred basis.

The primary reason for legislating a rollover to a self-benefit trust appears to be pragmatic. These trusts are often referred to as "politicians' blind trusts", which must be established to comply with federal

32. Section 73(1.02)(*b*)(ii).
33. In addition to the listed conditions, at the time of the transfer, both the taxpayer and the trust must be resident in Canada, and the taxpayer must have created the trust after 1999.
34. As determined under s. 104(1.1).
35. Section 104(4)(*a*.4). Section 70(5) will also deem a disposition of the settlor's capital interest in the trust to occur immediately prior to death. To avoid double taxation of the accrued gain in the trust assets, para. (*a*.1) of the definition of "cost amount" in s. 108(1) applies to adjust the cost amount of the individual's capital interest to take into account the deemed disposition of the trust's property under s. 104(4)(*a*.4).

and provincial conflict-of-interest guidelines. A rollover to such a trust was also possible under the former definition of "disposition" in s. 54. The question is: Can a self-benefit trust be useful in other contexts?

The obvious advantage of a self-benefit trust is that a rollover is permitted on a transfer of capital property to the trust regardless of the settlor's age. As is the case with an *alter ego* trust, the self-benefit trust will avoid a deemed disposition every 21 years while the settlor is alive, but there is a deemed disposition of the assets in the trust at fair market value at the end of the day on which the settlor dies.[35] Also as with an *alter ego* trust, a number of other negative tax consequences ensue. Consider the following:

- The $500,000 capital gains deduction cannot be claimed on the deemed disposition on death.[36]
- The trust assets cannot be rolled to a spouse or common-law partner or, where applicable, to a child.[37]
- Losses realized by the trust cannot be used against gains in the deceased's terminal year, nor can losses in the estate be carried back to offset trust gains.[38]

Some of these negative tax costs, if anticipated, can be avoided or reduced. For example, assets transferred to a self-benefit trust can be rolled back out to the settlor tax-free, to allow the settlor to take advantage of losses or other tax attributes or roll them to a spouse or common-law partner. As well, the capital gains deduction could be claimed at the time of the transfer of assets to the trust, assuming the assets had appreciated sufficiently, but such gains may be subject to alternative minimum tax.

Are there other tax costs or benefits? This can best be answered through a series of questions.

Does s. 75(2) apply to attribute income, losses, taxable capital gains, and allowable capital losses to the settlor while alive? Yes. However, in contrast to an *alter ego* trust, if a capital gain realized in

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36. If the capital gain is the result of a deemed disposition (that is, the result of the application of s. 107(4.1)), it appears that the gain is not trapped in the trust and can be designated to a beneficiary. Section 107(4.1) applies to any trust to which s. 75(2) applied if property is distributed from the trust to a person other than the settlor or his or her spouse or common-law partner. Given that a capital gain potentially eligible for the capital gains deduction would otherwise be trapped in the trust on the settlor's death, this option might be considered if the assets cannot be distributed to the settlor.
37. Section 70(9) and (9.2) permit the rollover to a child of certain farm property, shares of a family farm corporation, or an interest in a family farm partnership.
38. See s. 164(6), which permits the personal representative to elect to transfer losses realized in the first taxation year of the estate back to the terminal year.

a self-benefit trust is attributed under s. 75(2), the attributed gain is eligible for the $500,000 capital gains deduction.[39]

Is it possible to take advantage of lower provincial tax rates? Yes. Although s. 75(2) applies while the settlor is alive to attribute income, losses, capital gains, and capital losses, it does not apply to the deemed disposition that occurs on death. The reason is the timing of the deemed disposition of the trust assets. The deemed disposition occurs at the end of the day on which the settlor dies. Since he or she is no longer a capital beneficiary at that time, s. 75(2) no longer applies. Thus, it appears that the deemed disposition of trust assets that occurs by virtue of s. 104(4)(*a*.4) at the end of the day on which the settlor dies will result in tax liability in the trust.[40] If the trust is resident in a province with a lower tax rate than that of the settlor, tax savings will result.

Can the trust properly be transferred to a testamentary trust? Yes, through the settlor's capital interest in the trust. If the self-benefit trust does not end on the settlor's death, the settlor can transfer his or her capital interest in the trust directly to a beneficiary under his or her will or to a testamentary trust.

If the capital interest in the self-benefit trust is bequeathed to a testamentary trust, a number of options are available. First, the self-benefit trust can continue for at least another 21 years before a deemed disposition occurs, and throughout that period the self-benefit trust can distribute income to the testamentary trust.[41] The distributed income will be deductible to the self-benefit trust and taxable to the testamentary trust (or to the beneficiaries on distribution) at the applicable rates.

Second, if the trust deed includes a power of encroachment or a final distribution date, the assets of the self-benefit trust can be distributed to the testamentary trust using the rollover provisions in s.

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39. See s. 74.2(2) and *Interpretation Bulletin* IT-369R, "Attribution of Trust Income to Settlor", March 12, 1990, para. 8 (as amended by Special Release IT-369RSR, dated June 24, 1994):

> For purposes of the capital gains deduction under section 110.6, any taxable capital gain or allowable capital loss attributed to a person in a taxation year pursuant to subsection 75(2) is deemed, by virtue of subsection 74.2(2), to have arisen from the disposition by that person, in that year, of the property on which the gain or loss was realized. Consequently, a taxable capital gain attributed to a person under subsection 75(2) is eligible for the capital gains deduction to the same extent and in the same manner as if the gain had been realized directly by that person.

40. CRA document No. 2001-0114045, July 11, 2002; and CRA document No. 1999-0013165, May 15, 2000.

41. Section 104(4) and subpara. (*g*)(i) of the definition of "trust" in s. 108(1).

107(2). Unlike a transfer of assets from an *alter ego* trust, the transfer of assets to the testamentary trust appears to meet the requirements of a transfer "on and as a consequence of the death of an individual",[42] since the testamentary trust will acquire the capital interest in the self-benefit trust as a result of the settlor's death.[43] Third, the timing of the transfer to the testamentary trust may also take into account the election available under s. 107(2.001) to transfer the assets of the self-benefit trust at fair market value. The advantage of such an election would be to realize and utilize capital gains or losses in the self-benefit trust and maximize their tax value against any gains or losses that may arise on the deemed disposition of assets in the trust on the settlor's death.[44]

Can probate fees be avoided? Maybe. One method of avoiding probate fees is through the use of multiple wills. The trust assets or the settlor's capital interest in the self-benefit trust would simply be gifted under a separate will that does not require probate. It may also be possible to avoid probate altogether (and thus probate fees) if the trust terms provide that during the lifetime of the settlor, he or she is the sole income and capital beneficiary of the trust, but on the death of the settlor, the capital interest is to be transferred under a general power of appointment exercisable by a person named in the settlor's will.[45] In these circumstances, the exercise of the power of appointment is arguably just an amplification of the terms of the trust. The tax cost of avoiding probate is that a transfer of the trust assets to a testamentary trust does not appear possible. The use of a general power of appointment exercisable by will does, however, appear to meet the requirement of no change in beneficial ownership, a prerequisite for the initial rollover to the self-benefit trust.[46] This

42. Definition of "testamentary trust" in s. 108(1).
43. The acquisition of the capital interest and subsequent distribution of trust assets is conceptually no different than an acquisition of shares, for example, followed by redemption of the shares by the corporation. In either case, the distributed property remains property of the testamentary trust. If the capital interest in the self-benefit trust is transferred by will, it follows that probate fees will not be avoided if the will is probated. See also *infra*, footnote 53.
44. Although there are no formal technical interpretations, the CRA has opined informally that such a distribution is within the scope of the provisions in s. 107(2).
45. Consider the following. Mr. A, the settlor of a self-benefit trust and donor of the power of appointment, transfers assets to the trustee and includes in the trust terms a general power of appointment to himself as a beneficiary under the trust (donee) with respect to the beneficial interest in the trust. Under the terms of the trust, this power is granted only by will or other testamentary instrument of Mr. A. If such a clause is included, it follows that s. 75(2) will apply. See CRA document No. 2002-0162855, April 25, 2003.
46. CRA document No. 2000-0048735, May 24, 2001:

view is confirmed by the following statement, initially set out in explanatory notes issued by the Department of Finance and reiterated in a CRA technical interpretation:

> [W]here the individual is the sole income and capital beneficiary of a trust during his or her lifetime, the retention of a general power of appointment by the individual on the transfer of property to such a trust would not be expected to result in a change in beneficial ownership of the property for the purpose of a transfer described in s. 73(1.02)(*b*)(ii).[47]

If there is no change in beneficial ownership on the transfer of property to a self-benefit trust, does the settlor continue to beneficially own the trust property? Maybe. Who is considered the beneficial owner of property may have important implications for the purposes of a number of provisions in the Act. One example is whether control of a corporation has changed. If so, several tax consequences follow, including a restriction on the corporation's ability to deduct previously unutilized losses. Section 256(7) provides that control of a corporation shall be deemed not to have been acquired solely because of the acquisition, at any time, of shares of any corporation by a person who acquired the shares from a related person, or if the shares were acquired by a person who was related to the corporation.

Consider whether control of a corporation, Opco, will change if Opco shares are transferred by the sole shareholder, Ms. A, to a self-benefit trust. The CRA has opined that on a sale of Opco shares to the trust, if the trustee were not related to Ms. A, the transfer would result in an acquisition of control of Opco. This result occurs, in the CRA's view, because the trustee is viewed as the one who "acquires" the shares. If the trustee were not related to Ms. A, the trust and Opco would not be related prior to the transfer of the Opco shares. The relief in s. 256(7), otherwise available for transfers between related persons, is therefore not available. Thus, notwithstanding that there is no change in the beneficial ownership of the shares on a transfer to the

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> Where a power of appointment is exercisable only by will, the actual exercise of the power of appointment will arise as a consequence of the will of the holder of the power of appointment, if at all. As a result, notwithstanding subsection 248(25), a person's right to be appointed as a beneficiary of a trust under a general power of appointment which is exercisable only through the will of the beneficiary would not be considered to be a beneficiary for the purposes set out in subsection 104(1.1), including . . . subparagraph 73(1.02)(*b*)(ii) and . . . paragraph 107.4(1)(*e*).

47. *Ibid.*, and Canada, Department of Finance, "Explanatory Notes Relating to Income Tax" (Ottawa: Department of Finance, March 2001), cl. 53.

self-benefit trust, it appears that a change in control of the corporation would result if the trustee were at arm's length with the corporation.[48]

A second example of the importance of who "beneficially owns" the shares is found in s. 85.1, which allows a tax-free rollover on a corporate takeover in what is commonly called a share-for-share transaction. The rollover is denied if, after the transaction, the vendor or persons with whom the vendor did not deal at arm's length, or the vendor together with persons with whom the vendor did not deal at arm's length, "beneficially owned" more than the permitted percentage of shares of the capital stock of the purchaser.[49] Consider whether one continues to "beneficially own" the shares in a self-benefit trust for the purpose of this provision if there is no change in beneficial ownership on a transfer of shares to the trust.[50]

Assuming the settlor is 65, does a self-benefit trust offer tax advantages that an alter ego trust does not? Maybe. A comparison of both alternatives reveals that both permit a rollover of capital property to the trust and result in a deemed disposition of trust assets on the settlor's death. Thus, both types of trusts operate to deny a rollover to a spouse or common-law partner, to a trust for either, or to a child on the settlor's death. Both also isolate losses and gains realized in the trust from those realized by the estate[51] or in the terminal year. If the trust terms are appropriately drafted, both also appear to avoid probate fees.

The use of a self-benefit trust does allow access to the capital gains deduction to the extent that s. 75(2) is applicable.[52] It also provides interprovincial planning opportunities with respect to taxable income arising as a result of the deemed disposition on the settlor's death. It also appears that a capital interest in the self-benefit trust could be transferred by will to a testamentary trust on death.[53]

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48. CRA document No. l 2001-0019525, December 13, 2000.
49. The specific wording of s. 85.1(2)(*b*) is as follows:

> (2) Subsection 85.1(1) does not apply where
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> . . . . .
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> (*b*) the vendor or persons with whom the vendor did not deal at arm's length . . .
> (i) controlled the purchaser, or
> (ii) beneficially owned shares of the capital stock of the purchaser having a fair market value of more than 50% of the fair market value of all of the outstanding shares of the capital stock of the purchaser, immediately after the exchange.

50. One interpretation is that the trust itself is the vendor and the tax entity that beneficially owns the shares.
51. See *supra*, footnote 39.
52. Section 74.2(2).
53. It follows that if the capital interest is transferred by will, probate duties will not necessarily be avoided, because the capital interest is being transferred under the

Are there better alternatives to the use of a self-benefit trust? Maybe. The answer to this question will again depend on the settlor's primary objective. For example, if the objective is the avoidance of probate fees, a better option may be to simply move the property into a "bare trust." If the objective is to avoid a deemed disposition on death, a better alternative, discussed below, may be to avoid the rollover on the transfer to the *inter vivos* trust.

4. Bare Trusts

Bare trusts are no longer considered trusts for the purposes of the Act, but rather are considered agents for the beneficiaries. As a result, a transfer to a bare trust is ignored for most income tax purposes. For a transfer to be ignored, however, the trust must meet the specific requirements set out in s. 104(1). Not all bare trusts, as that concept is understood at common law, fall within these requirements, but rather only those trust arrangements "under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to . . . all of the trust's property."[54]

Where a bare trust is disregarded for purposes of the Act, assets held by the bare trust are deemed to have been disposed of at death under s. 70(5) and any gains are taxable in the hands of the beneficiaries. Assets held by the bare trust are also considered to be owned by the beneficiaries while they are alive. Thus, the beneficiaries may claim personally any tax write-offs associated with the property.

Can probate fees be avoided? Yes, assuming there is no other reason to file for probate. Probate duties may be avoided because, regardless of a statutory provision to ignore certain bare trusts for purposes of the Act, a trust exists at common law. The critical issues in avoiding the need to file for probate thus remain who holds the legal and beneficial title to the assets and how beneficial ownership of the trust assets is transferred. If the trust property is transferred under a power of appointment exercisable by will on the settlor's death, it appears the need to file for probate will be avoided. The reason is that the deceased will not hold legal title at death, the key requirement for filing under probate legislation, but rather will have enjoyed only a right to beneficial enjoyment of the trust property.[55]

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terms of the will and not pursuant to a power of appointment set out under the terms of the trust.

54. Section 104(1). These requirements differ from the CRA's former administrative view of when such a relationship existed. See *Income Tax Technical News* No. 7, *supra* footnote 6. As the trustee must act as an agent for all of the beneficiaries, this is not a good alternative if the settlor is concerned about potential personal incapacity.

55. The use of a bare trust to avoid probate relies on the fact that the estate trustees, or executors, hold legal title to the assets, even though the deceased may have enjoyed the beneficial title.

Can a partial disposition of the transferred property be achieved? Yes. If the transfer to the so-called agent/trustee includes a change in beneficial ownership of the property, a partial disposition may occur.[56] This will permit a partial realization of gains or losses[57] on the transfer of legal title, an option that may meet the settlor's objectives. For example, the settlor may wish to realize a partial disposition on the transfer of QSBC shares in order to claim the capital gains deduction. This can be achieved by adding a child, for example, as a beneficiary under the trust.

5. Revocable and Resulting Trusts

Revocable trusts[58] are also typically used to avoid the potential impact of probate taxes. The trust deed generally establishes the settlor as a trustee and, during his or her lifetime, as the sole beneficiary. Generally, the settlor retains the ability to revoke, alter, or amend the terms of the trust at any time, and the unfettered ability to deal with the trust property during his or her lifetime. To achieve the desired probate avoidance result, the trust deed vests the income and capital interests in beneficiaries other than the settlor at the time of the settlor's death.

A transfer of property to a revocable trust will result in a taxable disposition for purposes of the Act.[59] A disposition occurs because the trust deed provides for a change in the beneficial ownership of the property on the death of the settlor. Are there potential tax benefits from a transfer of property to a revocable trust? Consider the following questions.

Can losses be realized on a disposition of assets on a transfer of property to the revocable trust? Maybe. Section 40(2)(*g*)(i) of the Act

56. For example, the transfer will trigger a partial disposition if the bare trustee holds property as agent for two or more beneficiaries and only one owned the property prior to the transfer. See also s. 43.1, if the disposition is of real property in which the settlor retains a life interest.
57. See *infra*, footnote 62.
58. The term "revocable trust" is somewhat misleading. The CRA uses the term to refer to a trust to which s. 75(2) applies. Section 75(2) may apply, however, in many circumstances other than the classic revocable trust. For trust law purposes, a revocable trust is one in which, pursuant to the terms of the trust, an express power to revoke the trust has been reserved by the settlor from the outset (see *Schmidt v. Air Products of Canada Ltd.* (1994), 115 D.L.R. (4th) 631, [1994] 2 S.C.R. 611 *sub nom. Schmidt v. Air Products Canada Ltd.*, 3 E.T.R. (2d) 1). "Revocable trust" is used herein in the broader CRA sense. See also *Income Tax Technical News* No. 7, *supra* footnote 6.
59. See paras. (*c*), (*f*), and (*g*) of the definition of "disposition" in ss. 248(1) and 107.4(1)(*a*).

denies a loss that is “superficial,” as defined in s. 54. The superficial loss rules apply only if an “affiliated person” acquires the property.[60] The CRA has opined that the acquisition of property by, for example, an RRSP (registered retirement savings plan) trust within 30 days of the initial disposition would not constitute an acquisition of the property by an affiliated person unless the settlor were the sole trustee or controlled the trustee’s decisions.[61] It follows that a similar result would occur on the transfer of property to a revocable trust; that is, the loss would not be denied unless the settlor were the sole trustee or otherwise controlled the trustee’s decisions. Unfortunately, this ability to claim the loss may become more restricted as a result of the 2004 federal budget proposals, which introduced new provisions that will affect the definition of “affiliated persons” in the context of trusts. These new provisions look to the interest held by the beneficiary in the trust rather than the characteristics of the trustee to determine affiliation.[62]

Is a deemed disposition avoided on death? Yes. The revocable trust also seems to be a vehicle that can be used to avoid a realization of taxable capital gains, recapture, or other income inclusions on death without any diminution in the donor’s control of the property. Thus, one of the obvious and potential benefits of transferring property to a revocable trust is the ability to transfer assets to the next generation without a tax cost. Consider the following example.

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60. See CRA document No. 2001-0093405, December 5, 2001. According to the CRA,

> . . . pursuant to subsection 251.1(1) of the ITA, a natural person cannot be affiliated with a trust. However, pursuant to paragraph 2 51.1(4)(*a*) of the ITA, a natural person is affiliated with a trust when that person is the sole trustee of the trust or when, in that person’s capacity as trustee, that person controls the trust’s decisions.

61. The question in CRA document No. 2001-0088484, August 1, 2001, was whether an individual who disposed of shares at a loss in circumstances where an RRSP trust subsequently acquired the shares would be denied the loss under the stop-loss rules in s. 40(2)(*g*)(i). However, according to the CRA, GAAR may apply if there is no bona fide business reason for the transfer. In the context of a transfer to a self-benefit trust, an additional question may arise if an election is made to transfer the asset at fair market value. The loss is denied under the superficial loss provisions if the transferred property can be said to be “acquired” by the individual or a spouse or common-law partner of the individual. At issue in the case of a self-benefit trust will be whether an acquisition of property by the trust is an acquisition of the property by the individual if there has been no change in beneficial ownership on the transfer.

62. See Canada, Department of Finance, 2004 Budget, Budget Plan, Notice of Ways and Means Motion To Amend the *Income Tax Act*, March 23, 2004, resolution 19, December 6, 2004 Notice of Ways and Means Motion and Bill C-33, introduced December 8, 2004. As a result of the proposed amendments, applicable after March 22, 2004, a person will be considered affiliated with a trust if the person

Elena acquires an apartment building. She wants to enjoy the tax benefit of the capital cost allowance deduction currently but avoid recapture on death. She also wants to be able to access the trust capital if needed. Elena can transfer the apartment building to a revocable trust in which she holds an income interest. Under the terms of the trust, Elena will also receive a power of appointment, exercisable only by will, to name the new capital beneficiaries of the trust on her death.

While Elena is alive, the rental income earned by the trust can be distributed to her. An election under s. 104(13.1) by the trustee will ensure that this income is not taxable to Elena but rather to the trust, in which the capital cost allowance deduction can be claimed. When Elena dies, there is no deemed disposition of her income interest in the trust under s. 70(5) since it is not capital property. There is also no deemed disposition of a capital interest since Elena does not hold such an interest. If Elena's power of appointment to name the new capital beneficiaries of the trust is exercised in her will, the trust asset will roll to the beneficiaries by virtue of s. 107(2). This will result in the avoidance of both recapture and a capital gain on the disposition of the asset by the trust. It will also result in the avoidance of a deemed disposition on Elena's death, unless the power of appointment is deemed to have been disposed of for the purposes of s. 70(5)[63] or a "disposition" occurs at the time the power of appointment is exercised — both unlikely outcomes under the current tax regime.

The same result — that is, the avoidance of tax liability on death under s. 70(5) — can be achieved by establishing an *inter vivos* trust that fails on the settlor's death. To create such a trust, the trust deed should provide Elena with an income interest in the trust during her lifetime but omit any reference to a disposition of the trust capital on her death. Alternatively, the trust deed could expressly provide that the trust terminates on Elena's death, but make no reference to the ultimate distribution of the trust capital. In these circumstances, there would be a resulting trust on Elena's death and the trust assets would form part of her estate; or, put differently, the trust assets would revert to the settlor by operation of law upon the failure of beneficiaries.

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is a "majority interest beneficiary" of the trust. Such a beneficiary is, in general terms, a person who owns more than 50% of the fair market value of the income or capital interest in the trust. It follows that unless the person transferring property to the trust were prepared to dilute his or her interest in the trust by the addition of other non-affiliated beneficiaries, a loss on property transferred to the trust could not be claimed if the proposed amendments are enacted. See also Catherine A. Brown, "Trusts, Losses and Affiliated Persons: The New Legislation: What the Prudent Trust or Estate Practitioner Should Know" (2005), 24 E.T.P.J. 98.

Because Elena's estate first receives the asset upon her death, one must consider whether other deemed or actual dispositions occur. In particular, one must consider what cost base attaches to the trust asset acquired by the beneficiaries. The most obvious conclusion is that the trust asset will roll from the trust to Elena's estate under s. 107(2), as her estate becomes the beneficiary under the resulting trust by operation of law. A rollover should also occur on a transfer of the trust asset from the estate to the beneficiaries under the will. As a result, a disposition of the apartment building is deferred from the time of Elena's death until it is subsequently sold or otherwise disposed of by the beneficiaries.

If we assume that Elena acquires a capital interest in the trust in addition to her income interest (for example, because she wishes to transfer the cash flow from the building to a testamentary trust on her death), a tax deferral can also be achieved. It is achieved because the deemed disposition on death under s. 70(5) will be in respect of Elena's capital interest in the trust and not in respect of the apartment building. Thus, the taxation of the potential recapture is avoided. The cost base of Elena's capital interest on disposition is calculated by a formula that includes the cost base of the asset to the trust.[64] Any potential recapture is deferred until the property is disposed of, either by the trust or by the beneficiary.

Further planning may result in additional tax savings. For example, it appears clear that a disposition of the asset by a beneficiary (including a testamentary trust) is preferable if the capital interest in the revocable trust is transferred by will or on intestacy. This is because the beneficiary will acquire the capital interest on Elena's death at the deemed proceeds of disposition under s. 70(5) — that is, at fair market value.[65] When the asset is distributed from the trust in satisfaction of the capital interest, the beneficiary will receive a bump-up in the cost base of the asset to reflect

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63. It has been suggested that an attempt to tax the donee of a power of appointment "depart[s] from fundamental proprietary concepts". See Maurice C. Cullity, "Powers of Appointment" in *Report of Proceedings of the Twenty-Eighth Tax Conference*, 1976 Conference Report (Toronto: Canadian Tax Foundation, 1977), 744-62, at p. 749. The CRA has confirmed that a power of appointment is not considered to be property in itself and thus is generally not subject to the deemed disposition rules in s. 70(5). However, a power of appointment may affect the value of an interest in the trust that is held by the holder of the power. CRA document No. 2002-0129675, November 12, 2002.
64. See s. 107(1) and para. (*b*) of the definition of "cost amount" in s. 108(1). For example, if the undepreciated capital cost of the apartment building is $40, it appears that this will be the cost of the capital interest for purposes of the deemed disposition rules in s. 70(5).
65. Section 70(5).

the adjusted cost base of his or her capital interest.[66] As a result, double taxation of the gain is avoided. In contrast, if the apartment building were sold by the trustee, the full recapture and capital gain on disposition would be taxable to the trust, notwithstanding the deemed disposition of Elena's capital interest in the trust on her death.

If all interests in the trust are vested indefeasibly,[67] the 21-year deemed disposition rule will not apply.[68] If the 21-year deemed disposition date is a factor, the corpus of the trust might be distributed to the beneficiary shortly before the expiration of the 21-year period.[69]

Does s. 75(2) apply if the trust is revocable? Yes. Section 75(2) applies to attribute trust income to the settlor during the lifetime of the settlor while he or she is resident in Canada. However, the fact that s. 75(2) is applicable should not necessarily be a deterrent to the creation of a revocable trust. It seems reasonably clear that the existence of a power of revocation does not make the settlor the owner of the trust corpus for the purposes of the deemed disposition on death provisions in s. 70(5). A revocable trust may therefore be useful to avoid a deemed realization that would otherwise occur immediately before the death of the settlor while allowing the settlor the option of retrieving the property for his or her own use while alive.

Can taxpayers who otherwise meet the requirements for a rollover to an alter ego or self-benefit trust benefit from these tax provisions? Yes. If the taxpayer prefers that the *alter ego* provisions not apply, and he or she is 65 or older, an election must be filed under s. 104(4)(*a*)(iv)(A). If no election is filed and the conditions for the rollover are met, the rollover to the *alter ego* trust occurs automatically and the *alter ego* trust provisions will be applicable. Similarly, if the taxpayer meets the requirements for the rollover to a self-benefit trust,

66. Section 107(2)(*b*) and (*d*) and s. 107(1.1)(*b*)(i).
67. "Vested indefeasibly" means vested in the beneficiary or trust without the possibility of divestment by "a condition subsequent or a determinable limitation set out in the grant" creating the interest: see *Boger Estate v. M.N.R.* (1991), 43 E.T.R. 27, [1992] 1 F.C. 152, 91 D.T.C. 5506 at p. 5514 (F.C.T.D.), affd 50 E.T.R. 1, [1993] 2 C.T.C. 81, 93 D.T.C. 5276 (F.C.A.). See also Catherine A. Brown, "The Taxation of Trusts: Reconciling Fundamental Principles" (2001), 21 E.T.P.J. 1 at pp. 41-3.
68. See the definition of "trust" in s. 108(1).
69. It is possible that an exercise of the power of revocation might produce a disposition by the trust that would not be regarded as having been made in satisfaction of any beneficial interest of the donor. It seems this would occur only if the trust were collapsed and the property distributed to the settlor. Even in that situation, it could be argued that, by exercising the power, the settlor would obtain a capital interest and that any distribution of property by the trust would be in satisfaction of his or her capital interest.

an election must be filed under s. 73(1). If the election is not filed, the rollover and subsequent application of the self-benefit trust provisions are also automatic.[70]

6. Section 107.4(1) ("QD") Trusts

Section 107.4 introduced the concept of a rollover to a trust where the transfer is a qualifying disposition. In the context of a trust for an individual, these rollover provisions apply on a transfer of property, other than capital property, to a trust if the following conditions are met:

- there is a change in legal title but no change in beneficial ownership;
- the disposition is not by a person resident in Canada to a non-resident trust;
- immediately after the transfer, no person other than the contributor holds an absolute or contingent interest of any kind in the trust;
- the proceeds are not determined under any other provision of the Act (disregarding ss. 69 and 73); and
- s. 73(1) does not apply notwithstanding that certain conditions in s. 73(1) were not met.

This rollover occurs because the transfer of property to the trust is considered to be a qualifying disposition. Accordingly, a trust to which such a disposition is made is referred to as a "QD trust" for the purposes of this article.

The QD trust provisions allow the rollover of, for example, resource properties and land inventory to a trust for the individual's sole benefit. The transferor may elect to transfer the property at any amount that is not less than the cost of the property and not more than its fair market value.[71] Whether or not the election is made, s. 107.4(3) applies to determine (1) the transferor's proceeds of disposition (the new cost base of the transferred assets to the trust), and (2) the cost base of the transferor's capital interest and, where relevant, income interest in the transferee trust.

If the property is rolled to a personal trust, the transferor's proceeds of disposition are generally considered to be the cost amount of the property to the transferor, subject to a reduction if the fair market value of the transferred property is less than its cost amount.[72] Precise rules also determine the cost base of a taxpayer's interest in the trust. In the case of a qualifying disposition to a personal trust, the cost to the

70. Sections 73(1.01) and 73(l.02)(*b*)(ii). The election is filed under s. 73(1).
71. Section 107.4(3)(*a*)(1).
72. Section 107.4(3)(*b*).

transferor of an interest in the trust is generally deemed to be nil.[73] Notwithstanding, a sale of a capital interest in the trust rather than, for example, a resource property transferred to the trust may provide the taxpayer with a better overall tax result.[74]

The trust assets are subject to a deemed disposition on the settlor's death[75] and potentially every 21 years thereafter.[76] Like the self-benefit trust, this trust appears both to qualify for the rollover and to avoid probate if a general power to appoint subsequent capital beneficiaries is set out under the trust terms and exercisable under the will of the settlor.

7. Joint Spousal or Common-Law Partner Trusts

A joint spousal or common-law partner trust (defined in s. 248(1), and referred to herein as a "joint conjugal trust") is similar to an *alter ego* trust, except that the Act permits both the settlor and the spouse or common-law partner of the settlor to defer a deemed disposition of trust assets until the death of the survivor of them. Thus, the joint conjugal trust provides the potential benefits of probate savings, confidentiality, creditor proofing, and so on, which are available to an *alter ego* trust, but allows both spouses or common-law partners to receive benefits from the trust. Generally, a trust will qualify as a joint conjugal trust to which property can be transferred on a tax-deferred basis if an individual who is 65 years of age or older creates a trust after 1999, by declaring a trust over property or by transferring property to a trustee to be held upon certain trusts, and under the terms of the trust,

- the individual and his or her spouse or common-law partner, in combination with one another, are entitled to receive all of the income of the trust that arises prior to the death of the survivor of them; and
- no person, other than the individual or his or her spouse or common-law partner, is able to receive or otherwise obtain the use of any of the income or capital of the trust until the death of the survivor of him or her.

If a decision is made to establish a joint conjugal trust, there are two main alternatives. The first is to name the settlor and the settlor's

73. Section 107.4(3)(*m*)(i).
74. See s. 107(1) and the definition of "cost amount" in s. 108(1).
75. Section 104(4)(*a*.4).
76. See s. 104(4).

spouse or common-law partner as the sole income and capital beneficiaries of the trust during their lifetime and their children as contingent capital beneficiaries to benefit after the death of the last to die of the settlor and his or her spouse or common-law partner. The second alternative is to name the settlor and the settlor's spouse or common-law partner as the sole income beneficiaries and the spouse as the capital beneficiary during the lifetime of the settlor. Under this alternative, the settlor is not a capital beneficiary of the trust. The children are usually the contingent beneficiaries of the trust and will benefit after the death of the last to die of the settlor and the settlor's spouse or common-law partner. There are several advantages to the use of either alternative. The deemed disposition of assets in the trust on death is delayed until the death of the last to die of the settlor and the settlor's spouse or common-law partner. Probate is avoided as assets are transferred in accordance with the trust instrument. The *inter vivos* transfer also limits the possibility of variation to the will.

The primary disadvantage of the first alternative is that s. 75(2) of the Act will apply to attribute income to the settlor so that no interprovincial tax planning is possible with respect to the attributed income. If the second alternative is used — that is, if the settlor is not a capital beneficiary of the trust — provincial tax planning is possible, if s. 75(2) of the Act does not otherwise apply. Another advantage is that the settlor's creditors are limited to 50% of the income interest, as the settlor is not a capital beneficiary.

A joint conjugal trust is considered to be more flexible than a trust for a spouse or common-law partner (conjugal trust) in that it permits both the settlor and his or her spouse or common-law partner to receive distributions until the death of the survivor of them.[77] The tax cost is a deemed disposition of all the assets in the joint conjugal trust on the death of the surviving spouse or common-law partner.

The same length of deferral — that is, until the survivor's death — can also be achieved by the use of a rollover to a conjugal trust created on the death of the settlor. The significant tax difference is that a conjugal trust established on the death of the first spouse or common-law partner will be a testamentary trust and thus subject to progressive tax rates. This difference may not initially appear significant as all trust income must be payable to the spouse or common-law partner during his or her lifetime in order to achieve the rollover. Thus, it seems that little trust income may benefit from the testamentary trust's progressive tax rates. Such a conclusion, however, ignores the possibility of an

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77. Distributions from the trust to a spouse or common-law partner are subject to the attribution rules in s. 74.

election under s. 104(13.1) to have income taxed in the trust. The availability of progressive tax rates may also prove significant if the trust earns undistributed taxable income such as capital gains or phantom income such as accrued interest. Testamentary trusts are also able to choose a fiscal year other than the calendar year. Finally, a conjugal testamentary trust may utilize the unused capital gains deduction of the surviving spouse or common-law partner on his or her death.[78]

It should also be noted that farm property, including shares of a family farm corporation or an interest in a family farm partnership, cannot be rolled from a joint conjugal trust to the settlor's children. Such a rollover is available if the farm property is transferred to a conjugal trust.[79]

Are there potential tax advantages to the use of a joint conjugal trust? Yes. Once a joint conjugal trust is established, the first deemed disposition occurs on the death of the surviving spouse or common-law partner. As discussed above, the length of the deferral is no different than if property is transferred on death to a conjugal trust. A transfer of property to a joint conjugal trust may prove useful, however, if matrimonial breakdown is contemplated and ongoing alimony is to be paid. If the assets are transferred to a joint conjugal trust, they are secured until the surviving spouse's or common-law partner's death. Adjustments to the income paid to the estranged spouse or common-law partner can be made over time. Trust capital can also be distributed under the trust terms to either the estranged spouse or common-law partner or the settlor. But for the joint conjugal trust, alimony obligations that continue after the payer's death may have to be satisfied out of assets that were subject to a deemed disposition on the payer's death.

The joint conjugal trust thus offers the advantage of a rollover, flexibility over the precise income flow to the estranged spouse or

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78. Section 110.6(12) allows the capital gains deduction of the deceased spouse or common-law partner to be used against gains arising in the trust on the deemed disposition of the trust assets on the death of that spouse or common-law partner. The provision was added to prevent perceived injustice. But for the provision, only a spouse or common-law partner who received property directly, instead of through a trust, could utilize the capital gains deduction. It follows that such a deduction should also apply on the deemed disposition of assets in a joint conjugal trust, to the extent that the surviving beneficiary has not fully utilized his or her capital gains deduction. Oddly, s. 110.6(12) was amended to exclude such a trust from this provision. Extreme caution should therefore be exercised if QSBC shares or QFP is to be transferred to a joint conjugal trust. At a minimum, steps should be taken to ensure that the capital gains deduction of each of the beneficiaries has been fully utilized prior to the transfer or that a power of encroachment is included in the trust terms.

79. Section 70(9.1) and (9.3).

common-law partner while the settlor is alive, access to the trust capital *inter vivos* if needed, and some control over who will be the ultimate capital beneficiaries of the trust.

8. Conclusion

The ability to transfer property to a trust on a tax-deferred basis has provided new opportunities for meeting estate-planning objectives. As has been seen in this article, tax deferral does not come without potentially significant tax costs. In some cases, a deemed disposition on a transfer of property to the trust may more effectively meet the taxpayer's overall objectives. The obvious conclusion to be drawn is that a careful analysis of the client's assets and objectives, as well as the range of traditional trust options, is required before the use of any of the new *inter vivos* trusts is recommended.