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**THIS EXAMINATION CONSISTS OF 4 PAGES (INCLUDING THIS PAGE)  
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**THE UNIVERSITY OF BRITISH COLUMBIA  
FACULTY OF LAW**

**FINAL EXAMINATION – APRIL 2019**

LAW 412  
Taxation of Trusts and Estates

Professor R. Weiland

**TOTAL MARKS: 100**

**TIME ALLOWED: 3 HOURS**

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- NOTE:
1. This is an open book examination. Candidates may refer to any materials.
  2. ANSWER ALL QUESTIONS

**THIS EXAMINATION CONSISTS OF 5 QUESTIONS**

MARKS

- 25 1. Art and Betty are age 66 and 62. They have been married for 10 years. Art has one daughter, Chelsea, 42, from a prior relationship. Betty has no children. Art owns a North Vancouver condo, FMV \$1.7 million, ACB \$750,000. He also has a non-registered investment portfolio with an aggregate FMV \$900,000 and ACB of \$310,000. (Betty will be separately represented and so you are not advising her.)

Art's intentions are that if he dies first, his assets should be held for the support of Betty during her lifetime. He wants Betty to continue living in the condo. On the death of the survivor of them, he wants the first \$500,000 of his assets to go to Chelsea to help her pay down her mortgage, and the rest to go to Canadian Parks and Wilderness Society (CPWS), a registered charity.

Art's relationship with Chelsea has been strained since Chelsea married Dan whose political views are too conservative for Art's taste. While Chelsea and Dan are financially secure and don't need the money, Art thinks there is a good chance Dan will convince Chelsea to try to challenge Art's estate plan. His banker told him that an alter ego or joint spousal trust might protect his estate, and told him to talk to a lawyer.

Art's priorities are that Betty is securely provided for, that Chelsea not receive more than he plans to give her, and that taxes are minimized so that as much of his estate as possible goes to CPWS. What advice would you give to Art to best achieve his objectives? Your advice should include (but does not have to be limited to) the type of trust you suggest and why, tax consequences on creating the trust, tax consequences on death of Art and/or Betty, and whether and how the charitable gift might reduce taxes payable on death.

- 25 2. Edgewater Enterprises Inc. is a private BC company carrying on an active business. It qualifies under the ITA as a small business corporation. Felicia Feng, 70, the founder of the business, owns 100 Class A voting non-participating shares (FMV \$100) and 5,000 Class C non-voting preferred shares with a redemption amount of \$1,000 each (aggregate FMV \$5 million). The Class C shares were issued to her in exchange for her former common shares in a freeze that she did in 2004. The Class B non-voting common shares are held by Felicia and Gabe as trustees of Feng Family Trust, settled in 2004. The beneficiaries of Feng Family Trust are Felicia and her spouse Gabe, their three adult children (all Canadian resident), and Feng Family Holdings Ltd. (an investment holding company the shares of which are owned by Felicia and Gabe personally).

(Question 2, continued)

None of Felicia and Gabe's children are active in the business. Felicia expects that in 3-5 years she will sell the company. The current value of the company (in total) is conservatively estimated at \$25 million and she expects that the value could easily grow to \$35 million in that time frame. The company is holding \$5 million in cash and short term investments which are not needed for the business. Felicia would like some of the growth to benefit her 5 grandchildren who are currently between 17 and 22 years old, and hopes they can use their lifetime capital gains exemptions on a future sale. The company pays salary and dividends to Felicia but income splitting to other family members is not a primary consideration.

Your supervising lawyer asks you to address the following, with reference to the relevant ITA provisions. Can the parents and children use their lifetime capital gains exemption to reduce taxes on a future sale of the shares of Edgewater? What planning steps can be taken to allow the grandchildren's exemptions to be used? What attribution rule could prevent the desired result, and how can it be avoided in the planning steps? What other steps should be taken now and in the future to ensure the exemption can be claimed? What planning should be undertaken in 2025 if the company has not been sold?

- 20      3.      Harp, 51, immigrated to BC in the 1990s. His father Jeet is 76 and lives in India (and has never lived in Canada). Jeet has recently sold a large real estate portfolio in India and wants to settle approximately CAD \$20 million of his proceeds on a discretionary trust for the benefit of Harp and Harp's children in Canada. Jeet wants the trust to be managed by a competent professional trustee but does not care if the trustee is in Canada or in a low tax offshore jurisdiction like the Channel Islands. Jeet has held off on taking any steps while Harp gets tax advice from you.

Harp has the following questions about the tax planning opportunities. If the trust was managed in Canada, how will the trust be taxed on its investment income retained or paid to him or his children? Could Canadian tax be reduced or eliminated by using a non-resident trustee, or would the trust be taxed in Canada regardless? Would it work to have a non-resident trustee who invests the funds with Harp's Vancouver investment counsel whom he meets with regularly? Would anything change if Jeet decided to immigrate to Canada?

- 15      4.      Kate bought her house in Victoria in 1992 for \$125,000. She died in 2012. Under her will, she left the house (then worth \$425,000) in trust for the benefit of her surviving spouse, Lynn, for Lynn's lifetime. Under the trust, Lynn is entitled to live in the house (or any substitute residence acquired by the trust) and is entitled to all of the income that may arise (if any), and no one other

(Question 4, continued)

than Lynn may before her death receive or otherwise obtain the use of any of the income or capital of the trust. Lynn has lived in the house from 2009 to present. The trust requires Lynn to pay property taxes and expenses to maintain the house. The trust provides that on Lynn's death, the house (or any substitute) is to be sold and the proceeds divided between Kate's two children (who are not Lynn's children by adoption or otherwise). Because the intent was to eventually provide for Kate's children, the trust does not allow for the capital to be distributed to Lynn. Kate's son Max is an investment banker in New York City. He does not care about his future interest in this trust and would be happy if it all went to his sister Nan who is Canadian resident.

Lynn has a number of questions about the trust. If the trust sells the Victoria house and buys a condo for her in Nanaimo, will the trust have to pay tax on any part of the capital gain? Why or why not? Will the house be exempt from the new Speculation and Vacancy Tax because it is her principal residence? If any problems arise from the foregoing, is there a way to change or vary the trust to get a better result?

- 15     5.     The Osborne Family Trust was settled on April 10, 2004 for the benefit of the children of Oscar and Pam Osborne. The trust assets include blue chip public company shares with significant capital gains. The trust states that the property will be divided between their four children when the youngest turns 22, or an earlier date determined by the trustees. The trust includes a broad power of advancement (permitting distribution of capital to other trusts for the benefit of the beneficiaries), and the power to add individuals and trusts as additional beneficiaries.

In 2019, the Osbornes contact you concerned that the distribution date (3 years away) may be too early. They now think that distribution should be delayed until the youngest turns 35. You determine that the 2002 trust can't be amended, but you could help them set up a new Osborne 2019 Family Trust which would provide for a distribution of the trust assets to the same beneficiaries when the youngest turns 35. All other terms will be the same. All the assets of the 2002 trust could then be transferred to the 2019 Trust.

a.     With reference to the relevant provisions in the *Income Tax Act*, describe how the assets of the 2002 Trust can be transferred to the 2019 Trust without realizing the accrued gains on the investments.

b.     Explain how, and when, the deemed disposition rules under section 104 will apply to the 2019 Trust.

END OF EXAMINATION