THE UNIVERSITY OF BRITISH COLUMBIA
PETER A. ALLARD SCHOOL OF LAW

FINAL EXAMINATION – DECEMBER 2020

LAW 564.001
Taxation of Partnership and Trusts

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EXAM PASSWORD: 5T5xHf
RESUME CODE: ABB549

TOTAL MARKS: 100

(8:50 AM PST) **PREPARATION TIME ALLOWED:** 10 minutes
(9:00 AM PST) **WRITING (INCLUSIVE OF READING) TIME ALLOWED:** 3 hours and 15 minutes

8:50-9:00 AM Preparation Time (Exam writing not permitted) – This time is given to students to download/print your exam questions once the exam has been made available online on Canvas, to read the Exam Password on this exam coversheet, to enter the Exam Password for the exam in Examplify, and to progress in Examplify until you see the **STOP SIGN,** where you will **WAIT until 9:00 AM**. **DO NOT proceed past the STOP SIGN**. **DO NOT begin typing your exam answers in Examplify until 9:00 AM!**

9:00 AM Exam Writing Time – At 9:00 AM, you may proceed past the STOP SIGN in Examplify and begin typing your exam answers. Students are required to calculate and monitor their own time for writing exams. All exam answer uploads will be monitored to ensure that typing of answers only occurred during the allotted Exam Writing Time.

This is an open book examination, meaning that you can refer to a copy of the Income Tax Act (Canada), any material handed out during the course and your study notes.

If you think you have discovered an error or potential error in a question on this exam, please make a realistic assumption, set out that assumption clearly in writing for your professor, and continue answering the question. Do not email your professor or anyone else about this while the exam is in progress.

ACADEMIC INTEGRITY

Any exam answers that raise suspicion of breaking any restrictions outlined on this cover page may be subject to being processed through academic integrity software. Students typing exam answers before or after the allocated exam writing time may receive a grade penalty.

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As this exam is being written off-campus and is unsupervised, any communication whatsoever (including, but not limited to in person, telephone, e-mail, text, social media, etc.) concerning the contents of this examination with anyone (other than the Student Services staff of the Allard School of Law) is strictly prohibited.

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Your answer file should be named, and the coversheet of your answers should be titled with:
  Your Exam Code, Course Number, Name of Course, and Instructor Name

i.e., 9999 LAW 100.001 Law of Exam Taking – Galileo

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Please stop writing, note the time that you stopped, and email studentservices@allard.ubc.ca immediately to notify them and discuss options. Please provide your phone number when emailing Student Services.

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INSTRUCTIONS:

A.   In this exam there are two (2) problem sets worth a total of 100 marks. Problem set #1 has 18 questions worth a total of 55 marks. Problem set #2 has two fact patterns, A and B, with questions worth 45 marks. Allocate your time accordingly.

B.   I assume everyone is writing their answers on a computer, but if you are handwriting your answers, please write legibly: I can't mark what I can't read.

C.   At the beginning of each new answer, please indicate clearly which question you are about to answer. For example, 1(7) means question 7 of problem set #1 and 2(A)(3) means question #3 of Fact Pattern A of problem set #2.

D.   Read the facts and questions carefully. Read the applicable sections of the Act carefully. Answer the question asked and **only** the question asked. Resist the temptation to cite sections of the Act that have nothing to do with the question asked. The exam is designed to be challenging but not tricky. Cite authority for your answers, including specific section references to legislation and case law, whenever possible. **If you get an answer right but do not cite the relevant authority you will lose marks or possibly even get zero, even if your answer is correct.**

E.   Short answers are preferred and expected if they point **directly to the sections necessary to support the answer**. If you find yourself writing a long, convoluted answer, likely you are going down the wrong path.

F.   Unless the question says so, you should not need to make any assumptions other than the facts stated in the question, but if you do make any assumptions, then state them clearly. Do not make an assumption that will eliminate the need to discuss an issue.

G.   When you cite section references you should give as specific a reference as possible (e.g. 104(4)(b)(iii)) rather than just 104) but you need not give the name of the reference (e.g., section, subsection) unless you are asked for it or the reference would be ambiguous without it.

H.   If a question is a "true or false" question, then you must give either **all** the reasons the question is true or **all** the reasons the question is false.

I.   In this exam the following rules apply:

        (i) all taxpayers are resident in Canada, unless the question says otherwise or requires you to determine a taxpayer's residence;

       (ii) all events take place in British Columbia unless otherwise indicated and all events take place on the date of this exam unless otherwise indicated;

       (iii) all proposed amendments to the Act and regulations and to any other statute studied in this course announced up to today's exam are now in force.

J.   **<u>Go back and read the instructions in (D) and (E).</u>**

(STOP SIGN)

LAW 564, Section 1

MARKS

55 MARKS – Problem Set #1 (18 Questions)

1. (1 mark)   What is the exact name of this provision: 104(5.8)(a)(D)(II)?

2. (3 marks) Why would a trustee ever want to allocate the trust's income to its beneficiaries?

3. (3 marks) True or false: if a corporation is a beneficiary of a trust and the trust carries on business, then the trust can flow its net business income through to the corporation, which can then claim the small business deduction on that income, because the corporation will have "income of the corporation for the year from an active business" within the meaning of subsection 125(7)?

4. (3 marks) True or false: if the same trust has a loss in a taxation year from the same business, then it can flow that loss through to the corporation?

5. (4 marks) True or false: Smith and Zhang started a romantic relationship eleven months ago. Smith now wants to transfer some shares of a private corporation to Zhang through a trust. The fair market value ("FMV") of the shares is greater than Smith's adjusted cost base ("ACB") of the shares. When Smith transfers the shares to the trust, Smith will not realize any gain or loss from the transfer?

6. (3 marks) True or false: if Smith uses the shares to set up an alter ego trust, Zhang can be the beneficiary of the trust after Smith dies.

7. (3 marks) True or false: Smith asks you to use the shares to set up a so-called "self-benefit trust" but, after Smith signs the Trust Deed, you realize that you have drafted the Deed so that the trustee has discretion to pay Smith any income earned by the trust. Therefore, Smith will have a gain on the transfer to the trust?

8. (3 marks) True or false: Smith and Zhang have been living together romantically for two years. Smith is on the way to see you about drafting a Will to leave the shares to Zhang when Smith dies in a car accident. Even assuming that Zhang is entitled to acquire the shares on an intestacy under the BC *Wills, Estates and Succession Act*, Smith will have a capital gain on the shares?

9. (3 marks) There was no car accident and Smith did not die, but on the way to see you, Smith decides to use the shares to set up an *inter vivos* trust for Zhang. You advise Smith that Smith's father should settle the trust with a $20 gold coin. You draft the Trust Deed so that the coin can never go back to the father. Why did you draft it that way?

10. (3 marks) True or false: as subsection 104(1) says that a reference to a trust is a reference to the trustees, then so long as the trustees are resident in BC, the trust can never be resident anywhere else?

11. (3 marks) Explain *briefly* what the 21-year rule is and why it is in the Act.

12. (4 marks) Explain *briefly* two ways to avoid the 21-year rule.

13. (3 marks) True or false: if Smith and Zhang are now married and Smith uses the shares to settle a trust in favour of Zhang on a rollover basis and then Smith dies, the trust will have an immediate capital gain on the shares?

14. (3 marks) True or false: Smith can use the shares to settle an alter ego trust under which Smith is the sole trustee?

15. (4 marks) True or false: if a trust earns a capital gain on shares that are eligible for the lifetime capital gains exemption and one of the beneficiaries is a three-year old child, then the trust can pay the gain to a friend of the child's mother to hold it until the child turn 19 years old and then the trust can deduct that gain from its income?

16. (3 marks) True or false: a trustee is separate from a trust and, therefore, never has any personal liability for the taxes owed by the trust?

17. (3 marks) True or false: if your client dies on May 1, 2021, then the terminal year return must be filed within 6 months of that date?

18. (3 marks) True or false: Smith's Will leaves the shares to Sam, Smith and Zhang's 16-year old child of their marriage, on the condition that Sam survives Smith for four years. Sam declines to accept the gift and so under the Will it goes automatically to Zhang, on the same condition. Therefore, Smith will have a rollover of the shares on death?

45 MARKS – Problem Set #2 (Two fact patterns)

Fact Pattern A

A new client, Strikeit Rich ("SR") has come to see you. SR has been working in the basement and has developed a possible cure for Covid-19. SR is pretty sure the cure is effective but has not tested it on humans yet, just mice. SR has been doing some research on the internet and has read that using a corporation to hold business assets will create a shield from liability if the cure does not work, someone dies from it and then wants to sue SR. SR wants to set up SR Ltd. ("SRL") and run the business of selling the cure through that corporation. SR hopes that the cure will be effective, SRL will earn billions of dollars, then SR will sell the shares and make a huge gain.

SR is not married but has been dating Pretty Lucky ("PL") for a few months. Things are looking hopeful in the relationship and they may get married and have children someday. SR has found some stuff on the internet about trusts and how they can be used to split income with your family.

SR decides to set up a trust ("Trust") to own shares in SRL. Under the Trust Deed, SR's friend will contribute a $20 gold coin and $100 to the Trust. PL will be a beneficiary. The Trust Deed will say that SR can add any of their children as beneficiaries of the trust. SR will be the sole trustee and have the discretion to pay income or capital to any beneficiary.

The Trust will use the $100 to subscribe for 100 non-voting, Class A shares of SRL at $1 per share. The Class A shares will be entitled to receive dividends and to a proportionate amount of any of SRL's surplus if SRL is ever wound-up. SR will subscribe for 100 Class B, voting shares of SRL. Those shares will be entitled to dividends and a proportionate amount of any of SRL's surplus if SRL is ever wound-up

1. (10 marks) SR is worried about paying money or distributing shares to children who are very young. In fact, SR would like to be able to keep the money in the Trust until the children are 40 years old. But, at the same time, SR wants to the Trust to be able to allocate any capital gains earned by the Trust to

the children so that they can use their lifetime capital gains exemption to shelter part of the gain. Can you suggest a solution?

2. (15 marks) It is now a year later. SR was right: the cure is effective, SRL has earned lots of money and its shares are now worth $1,000,001 per share. SR as trustee of the Trust decides to distribute one Class A share to PL. What are the tax consequences of that distribution?

Fact Pattern B

SR and PL were married many years ago and have two children, both over the age of 19. SR and PL still own shares of SRL personally, with an ACB of $1 and a FMV of $1,000,001 per share (the former trust has been wound up and all the assets distributed).

Sadly, SR dies. At the time of death, SR owned 100 Class B shares and PL owned 100 Class A shares of SRL. Under SR's Will, PL is to receive all of SR's assets through a new trust. PL is the executrix under the Will.

1. (5 marks) For purposes of the Act, what is the nature of the person who owns the Class B shares immediately after death?

2. (5 marks) What conditions must the trust have so that SR will not have a taxable capital gain in respect of the Class B shares on death?

3. (5 marks) The trust expects to receive $100 of dividends every year from SRL. PL is already earning $100,000 per year from a job. If the trust distributes the $100 to PL, she will pay tax at a 50% rate. If the trust keeps the $100, will it pay the same or less or more?

4. (5 marks) Suppose SR owned an antique desk that has a FMV of $2,010 even though SR paid only $10 for it. Before death, SR had agreed to sell the desk to one of the children at $1,010. Sometime after SR dies, the desk is sold to the child for $1,010. What are the tax consequences to SR and on the sale of the desk? If SR has to pay any tax, is there some way to reduce the amount payable?

<div align="center">END OF EXAMINATION</div>