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CORPORATE

— ESTATE ALERT

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Budget 2014: Changes to the Taxation of Trusts and Estates

by Lori Duffy

The Canadian Federal Budget was tabled on February 11, 2014 and contains several important changes to the taxation of trusts and estates.

We were somewhat prepared for this as a consultation paper had been issued by the government on June 3, 2013. Prior to this budget, the income earned in testamentary trusts and grandfathered *inter vivos* trusts (being those trusts that were settled during a settlor's lifetime before June 18, 1971) were taxed at the graduated tax rates for an indefinite period of time. This meant that beneficiaries of these trusts had access to graduated marginal tax rates and effectively allowed a form of income splitting between the beneficiary and the trust.

The 2014 budget provides that the highest marginal tax rate will apply to all grandfathered *inter vivos* trusts and to all testamentary trusts commencing in 2016 and all subsequent tax years.

There are two exceptions to this treatment. First, graduated rates will continue to apply for the first 36 months of an estate that arises on and as a consequence of an individual's death and that is a testamentary trust. This has been permitted as the government is recognizing that estates do require a period of administration and that estates are generally administered within their first 36 months. If the estate does remain in existence for more than 36 months after the date of death, it will then become subject to the highest marginal rates of taxation at the end of the 36 month period.

Second, the graduated rate of taxation of testamentary trusts that are structured for the benefit of disabled individuals will be continued. To qualify, the beneficiary of the trust must be an individual who is eligible for the federal Disability Tax Credit.

Furthermore, testamentary trusts (other than estates in their first 36 months) and grandfathered *inter vivos* trusts also received special treatment under other tax rules which will now no longer be applicable. They include:

1. an exemption from the income tax instalment rules;
2. an exemption from the requirement that testamentary trusts have a calendar year taxation year and fiscal periods that end in the calendar year in which the period began;
3. the basic exemption in computing alternative minimum tax;

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4. preferential treatment under Part XII.2 of the *Income Tax Act*;
5. classification as a personal trust without regard to the circumstances in which beneficial interests in the trust have been acquired;
6. the ability to make investment tax credits available to a trust's beneficiaries; and
7. a number of tax administration rules that otherwise apply only to ordinary individuals.[1]

It is important to note that testamentary trusts that do not already have a calendar year taxation year will have a deemed taxation year end on December 31, 2015 or, in the case of an estate for which the 36 month period ends after 2015, the date on which that period would end.

Given these changes, if you would like to revisit your current will, we would be happy to assist you.

[1] "Economic Action Plan 2014", Tax Measures: Supplementary Information, Notices of Ways and Means Motions and Draft Amendments to Various GST/HST Regulations.

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