READING 8-1

Income in the year of death

LEVEL 1

General

In computing income in the year of death, all income realized in the year of death must be declared under the regular rules as well as certain other income that would not have been taxed or realized immediately if the person had not died. Since the deceased person will not be filing any more income tax returns in the future, CRA must make sure that this person's tax obligations are all settled with his last return. Thus, income or gains accrued, accumulated, or deferred become immediately taxable. There are some exceptions to this rule, but they are limited, as you will see.

The rules for computing the income of a deceased person are mainly contained in sections 70 and 72. In some cases, the ITA allows elections to be made to reduce tax consequences on death, such as the filing of a separate return for certain types of income.

Periodic payments

Normally, an individual is taxed on his income, other than income from carrying on a business, on a cash basis. Under subsection 70(1), in computing the income of a deceased taxpayer, the value of interest, rent, royalty, annuity, remuneration from an office or employment, or other amount payable periodically that was accruing and was "earned" at the date of death but was not yet payable (hereinafter called periodic payments) must be added to income earned from the beginning of the calendar year.

If the deceased person had incurred expenses with respect to periodic payments, such expenses may be deducted even if they had not been paid at the date of death.

Periodic payments must be included in the deceased taxpayer's final tax return. These payments may not be included in a separate tax return.

Example 8-1 shows how subsection 70(1) applies in the case of accumulated remuneration.

EXAMPLE 8-1

Marika Côté died on March 15, 2008. She was employed by Bazooka Ltd. Her remuneration of $5,000 per month was paid on the last day of each month.

Tax consequences

The amount of salary earned but not yet due on the date of death is considered to be a periodic payment which must be included in Marika's final tax return:

$5,000 × (15 ÷ 31)	$2,419

Rights or things

In addition to income accumulated with respect to periodic payments that have not yet fallen due, the deceased may be entitled to receive certain amounts which, had they been received before death, would have been taxable. The person may also hold property whose value, had it been disposed of before death, would have been included in income. When this is the case, the value of these "rights or things" becomes immediately taxable.

Subsection 70(2) defines **rights or things** of a taxpayer as rights or things the amount of which when realized or disposed of would have been included in computing the income of the deceased taxpayer.

The following property is expressly excluded, under subsections 70(2) and (3.1), from the rules applying to rights or things:

- capital property
- periodic payments included in computing the income of the deceased taxpayer, under subsection 70(1)
- eligible capital property (ECP)
- resource property
- land included in the inventory of a business of the taxpayer
- life insurance policies

All such property is subject to specific tax rules.

Rights or things should be distinguished from periodic payments because they are treated differently for tax purposes. There is no tax relief available on the value of periodic payments included in computing a taxpayer's income on death, whereas the value of a taxpayer's rights or things on death may be treated in a number of ways.

Whereas periodic payments constitute amounts that have accrued but are not due at the time of death, rights or things constitute amounts that are due but that have not been paid on the taxpayer's death.

For example, Lai Wong owns bearer (or coupon) bonds at the time of death. The value of the interest accrued from the last interest payment date to the date of death constitutes a periodic payment. However, if interest coupons are due but have not been received, they should be considered as rights or things.

According to paragraph 3 of IT-212R3 as well as paragraph 4 of IT-210R2, any doubt as to whether the nature of income earned before a taxpayer's death is a periodic payment or a right or thing is generally resolved in favour of the taxpayer.

Some examples of rights or things are

- dividends declared but not paid on the date of death
- uncashed matured bond coupons
- amounts in respect of which an amount has been deducted in computing income such as the inventory of a farmer or fisherman using the cash basis or the inventory of works of art of an artist who elected to report his inventory as nil pursuant to subsection 10(6)
- unpaid salary, remuneration or commissions, including employment insurance and CPP benefits where these amounts were owed to the deceased at the time of death, and concerned pay periods ending before the date of death (such as retroactive wages following labour negotiations, an amount paid for unused sick leave)
- work in progress of a professional who elected to exclude work in progress in computing his income
- grain participation certificates
- rent due but unpaid when the cash basis is used

Read IT-210R2 and IT-212R3 for a discussion of periodic payments and rights or things.

Example 8-2 applies the concepts of rights or things and periodic payments to a simple situation.

EXAMPLE 8-2

Ray Hutchinson died on March 21, 2008. He held the following investments at the time of his death:

a. a bearer (or coupon) bond ($10,000) having the following features:

- interest rate of 4%, payable on November 1 of each year
- unclipped coupon on the date of death from November 2007: $400

b. 500 shares of Flexer Ltd. for which an eligible dividend had been declared at the time of Ray's death. The details regarding the dividend are

Dividend	Date declared	Ex-dividend	Date of record	Date payable
$1.00	Feb. 25	March 7	March 14	April 1

Tax consequences

1. Bearer Bond: Unclipped interest coupon of $400 on death is considered to be a right or thing.

   However, interest from November 1 to the date of death is considered to be a periodic payment and not a right or thing.

2. Dividend: The amount of the dividend declared but unpaid at the time of death (500 shares × $1.00 = $500) is considered to be a right or thing, since Ray was entitled to the dividend at the time of his death, which occurred after the ex-dividend date. The taxable amount of the dividend is the amount of the dividend grossed up by 45% under subsection 82(1).

The value of rights or things must be computed on the date of death after deducting expenses related to such items. Only expenses that are payable or incurred in respect of the rights or things are deductible.

Where the difference between the value of rights or things and the related expenses results in a loss, the loss may be deducted from the taxpayer's other income.

The value of rights or things must be included in computing the deceased taxpayer's income. However, subsection 70(2) allows the legal representatives to elect to file a separate return with respect to the value of rights or things.

This separate return must be filed no later than

- one year after the date of death

or

- 90 days after the date of mailing of any notice of assessment in respect of the tax of the taxpayer for the year of death, whichever is later

The separate return is considered to be the return of another person. Consequently, progressive rates apply to the income reported on this return. Furthermore, personal tax credits available in the regular return may also be claimed in the separate return. However, credits for charitable donations, medical expenses, pension income, physical or mental impairment, tuition, etc. are limited to the total amount which may be claimed if only one

return is filed. This amount may be claimed on either return or apportioned among the returns. The same rule applies with regard to deductions that can be claimed under section 110. These restrictions are contained in sections 118.93 and 114.2. Consult IT-326R3 which discusses the separate return and the credits allowed. Exhibit 8-1 (below) summarizes how deductions and credits can be claimed in various returns.

The election to file a separate return for rights or things may be revoked if the revocation is made within the time that an election may be made [subsection 70(4)].

If the deceased taxpayer's legal representatives do not wish to include a right or thing in the regular return or in a separate return, the right or thing may be transferred to a beneficiary of the estate before its realization. The beneficiary will be required to include the amount received on the realization of the right or thing in computing his income, after deducting the cost of the property to him. Under subsection 69(1.1), the cost is equal to the total of the two following amounts:

- the part of the cost to the deceased taxpayer as had not been deducted by him in computing his income for any year

and

- any expenditures made or incurred by him to acquire the right or thing

The right or thing must be transferred within one year after the date of death or within 90 days after the date of mailing of any notice of assessment in respect of the year of death, whichever is later. This is the same time period as for filing the separate return. In other words, the choice between filing a separate return and transferring the right or thing to the beneficiary must be made during this period.

The transfer of rights or things to a beneficiary is covered in subsection 70(3). It should be noted that in practice it is often difficult to transfer rights or things to a beneficiary before they are realized, since the legal representatives are generally not free to realize them at will. Transfer to a beneficiary is an option if the right or thing is one whose disposition can be controlled by the legal representatives, such as the works of a painter who elected to report his income as nil pursuant to subsection 10(6).

LEVEL 2

Business income

Separate return

Sole proprietor of a business with a fiscal period ending on a date other than December 31

On the death of the proprietor of a business, the fiscal period ends and the business income earned up to the date of death must be included in the proprietor's income for the year of death. In the case of an individual who has elected, according to the alternative method provided for in subsection 249.1(4), to have a fiscal period that does not coincide with the calendar year, this means, if the death occurs after the end of fiscal period, that the following must be included in his income:

- if he died after the end of the fiscal period, his business income for the fiscal period ending in the calendar year of death (the usual fiscal period)

plus

- his business income for the period between the end of the last fiscal period and the date of death (the short fiscal period)

Under subsection 150(4), when this occurs, the portion of the income between the end of the fiscal period and the date of death may be included in a separate return, as if the taxpayer were another person. This election is provided for in subsection 150(4).

However, it should be kept in mind that if an election is made to file a separate return, under subsection 34.1(9) it is necessary to include additional income in the income that must be reported in a usual return. This additional income is equal to the result of the following calculation:

$(A - B) \times C \div D$

where

A = income from the business for the usual fiscal period

B = the lesser of:

(i) an amount included in A which is deemed to be a taxable capital gain for the purpose of section 110.6, namely an amount included in A as a result of the disposition of property that qualifies for the CGD
(ii) the amount actually deducted during the year as CGD

C = number of days in the short fiscal period

D = number of days in the usual fiscal period

The amount included in the usual return must be deducted from the income for the short fiscal period reported in the separate return under subsection 150(4).

Considering the additional income that must be added to the income for the usual fiscal period, the election is advantageous only if the income for the short fiscal period is proportionally higher than that of the usual fiscal period. Otherwise there will be no income to report for the short fiscal period.

Filing a separate return is optional. In certain cases, it may reduce the tax liability of a deceased taxpayer having two taxation years ending in the year of death. On the other hand, it may not be in the taxpayer's interest to elect to file a separate return. This would be the case, for example, where the taxpayer had non-capital losses or capital losses that had not been used on the date of death.

Examples 8-3, 8-4, and 8-5 illustrate the tax treatment of a deceased person's business income. Example 8-3 illustrates a situation where death occurs before the end date of the fiscal period. Example 8-4 presents a situation in which an election to file a separate return may be made. Example 8-5 illustrates a situation where the election is not appropriate because the income for the short fiscal period is proportionally lower than the income for the usual fiscal period.

EXAMPLE 8-3

Lise Laplante died on September 1, 2008. The fiscal period of her business ends on December 31.

The income earned for the period from January 1, 2008, to September 1, 2008, being the date of death, must be included in the deceased taxpayer's final income tax return.

EXAMPLE 8-4

Ted Walker died on September 1, 2008. The fiscal period of his business ends on January 31 under the election made by virtue of subsection 249.1(4).

In 2007, Ted reported additional income of $40,000 under subsection 34.1(1). The business income for the period from February 1, 2007, to January 31, 2008, totals $80,000. The income for the period from February 1 to September 1, 2008, is $60,000.

Tax consequences

1. If the election provided for in subsection 150(4) is not made:

Income to be added to Ted's return for 2008	
• business income from February 1, 2007, to January 31, 2008	$ 80,000
• business income from February 1, 2008, to September 1, 2008	60,000
	140,000
Deduction for 2007 additional income	(40,000)
	$100,000

Note:

Pursuant to subsection 34.1(8), no additional income for 2008 need be added.

2. If the election provided for in subsection 150(4) is made:

Income to be included in Ted's return for the year of death	
• business income from February 1, 2007, to January 31, 2008	$ 80,000
• deduction for 2007 additional income	(40,000)
	40,000
• additional income [34.1(9)] ($80,000 – $0) × 213 ÷ 365	46,684
	$ 86,684
Income to be included in the separate return under 150(4)	
• business income from February 1, 2008, to September 1, 2008	$ 60,000
• deduction for additional income included in the usual return [150(4)]	(46,684)
	$ 13,316
Total reported	
• usual return	$ 86,684
• separate return	13,316
	$100,000

EXAMPLE 8-5

Return to the data in Example 8-4 but assume that the business income for the period from February 1, 2007, to January 31, 2008, totals $120,000. The income for the period from February 1 to September 1, 2008, is still $60,000.

Tax consequences

1. If the election provided for in subsection 150(4) is not made:

Income to be added to Ted's return for 2008	
• business income from February 1, 2007, to January 31, 2008	$120,000
• business income from February 1, 2008, to September 1, 2008	60,000
	180,000
Deduction for additional income for 2007	(40,000)
	$140,000

Note:

Under subsection 34.1(8), no additional income for 2008 need be added.

2. If the election provided for in subsection 150(4) is made:

Income to be included in Ted's return for the year of death

• business income from February 1, 2007, to January 31, 2008	$120,000
• deduction for additional income for 2007	(40,000)
• additional income [34.1(9)] ($120,000 – $0) × 213 ÷ 365	70,027
	$150,027

Income to be included in the separate return under 150(4)

• business income from February 1, 2008, to September 1, 2008	$ 60,000
• deduction for additional included in the usual return [150(4)]	(70,027)
	$ (10,027)

There is no income to report in the separate return. There is no advantage in making the election provided for in subsection 150(4); the income to be reported in the usual return would then be $150,027, and the loss of $10,027 would not be used, since a return filed under subsection 105(4) is considered as the return of another person.

Member of a partnership with a fiscal period ending on a date other than December 31

Where a person is a member of a partnership, different rules apply depending on whether or not the death of the partner causes the fiscal period of the partnership to end.

If the death of a partner causes the fiscal period of the partnership to end, the deceased partner's share of the partnership income for that fiscal period is included in the regular income tax return for the year of death. If the partnership had a previous fiscal year end in the calendar year in which death occurred, a separate return for the partnership's income for the period from the end of the partnership's regular fiscal period to the date of death may be filed as provided in subsection 150(4), applying the same rules as for a sole proprietorship. Under subparagraph 53(1)(e)(i), the income thus taxed is added to the adjusted cost base of the interest.

If the death of a partner does not cause the fiscal period of the partnership to end, the deceased partner's right to his share of profits of the partnership from the end of the last fiscal period to the date of death is a right or thing the value of which is to be included in income or the income of the beneficiaries, under subsection 70(2) or 70(3). It is therefore possible to file a separate return for rights or things with respect to the partnership's business income that is owed for the period between the end of the last fiscal period and the date of death. On this subject, read paragraphs 2, 3, and 4 of IT-278R2. The adjusted cost base of the interest in the partnership is increased by the value of the right to income under subparagraph 53(1)(e)(v). This adjustment is made immediately before the death, that is, on the date of the deemed disposition of the interest, so that there is no double taxation of this amount.

Note that there are proposals for amendments to the ITA that provide, retroactively to the 2003 taxation year, that the partnership income for the period up to the date of death shall be considered as income from the partnership added to the adjusted cost base of the interest under subparagraph 53(1)(e)(i) instead of subparagraph 53(1)(e)(v). CRA considers that this amendment does not change its position to the effect that a separate return for rights and things may be filed. **These proposals are not examinable.**

Income from a testamentary trust

A situation similar to that applicable to business income arises where the deceased taxpayer was a beneficiary of a testamentary trust whose taxation year does not coincide with the calendar year. Where the individual died after the end of the taxation year of the trust but before the end of the calendar year, the taxpayer's legal representatives may elect to file a

separate return under paragraph 104(23)(d) for the portion of the income earned after the trust's regular year end.

The comments relating to non-refundable tax credits and deductions in computing taxable income also apply to this separate return and the separate return for business income. In fact, personal tax credits may be claimed in each return whereas other non-refundable tax credits and deductions in computing taxable income must be allocated among the returns at the taxpayer's option.

Exhibit 8-1 shows how deductions in computing taxable income and non-refundable tax credits may be claimed on the different returns.

EXHIBIT 8-1

Claiming deductions or credits

Non-refundable tax credits that may be claimed on each return

- Basic personal amount
- Age amount
- Spouse or common law partner amount
- Amount for an eligible dependant
- Amount for children under 18 years of age
- Amount for infirm dependants age 18 or older
- Caregiver amount

Non-refundable tax credits that may be claimed on the different returns provided that the total amount claimed does not exceed the amount allowed if only one return were filed

- Amount for mental or physical impairment of the deceased person
- Amount for mental or physical impairment transferred from a dependant
- Charitable gifts, gifts to Her Majesty, and cultural and ecological gifts
- Medical expenses
- Tuition and education amounts for the deceased person
- Tuition and education amounts transferred from a child
- Post-secondary textbooks
- Interest on student loans
- Adoption expenses
- Eligible transit passes
- Amount in respect of children's physical fitness

Deductions in computing taxable income and non-refundable tax credits that must be claimed on the return on which the associated income is reported

- Stock options deduction
- Deduction for income exempted under a tax convention
- Deduction for loan to reinstate employees
- Vow of perpetual poverty deduction
- Social benefits repayment
- Pension income amount
- Contribution to employment insurance and the Canada Pension Plan or its equivalent
- Canada employment amount

Deductions in computing taxable income and non-refundable tax credits that must be claimed on the final return only

- Registered pension plan contributions deduction
- RRSP contributions deduction
- Child care expenses

- Attendant care expenses
- Allowable business investment loss
- Moving expenses
- Support payments made
- Losses of other years
- Capital gains deduction
- Amounts transferred from a spouse or common-law partner

LEVEL 1

Reserves

Under subsection 72(1), in computing the income of a deceased taxpayer in the year of death, no deduction is allowed for the following reserves:

- a reserve for property sold in the course of business where all or a portion of the sale price is not due until a date which may vary with the type of property but that is after the end of the taxation year [paragraph 20(1)(n)]
- a reserve for unearned commissions by an insurance agent or broker [subsection 32(1)]
- a reserve for any portion of the POD of a capital property that are not due to the taxpayer until after the end of the year as may reasonably be regarded as a portion of the capital gain [subparagraph 40(1)(a)(iii)]
- a special reserve for a capital gain realized from the making of a non-qualifying gift [paragraph 40(1.01)(c)]
- a reserve for capital gains, constituted in accordance with the rules on replacement property [subparagraph 44(1)(e)(iii)]
- a reserve in respect of the disposition of a resource property [subsections 64(1), 64(1.1)]

Thus, any reserve deducted in a previous year must be included in income for the year of death without claiming a new reserve.

The only reserves allowed are those claimed for doubtful accounts as well as rent paid in advance and amounts received before goods are delivered or services rendered.

Exception

However, subsection 72(2) provides for an exception where the right to receive an amount has been transferred to the spouse or common-law partner or to a "spousal" trust.

The conditions for the rollover of the reserve are

- the deceased taxpayer was resident in Canada immediately before his death
- the spouse or common-law partner must be resident in Canada immediately before the death or, if the property is transferred to a trust, the trust must be a spousal and common-law partner trust within the meaning of paragraph 70(6)(b)
- the right to receive an amount has, on or after the death of the taxpayer and as a consequence thereof, been transferred or distributed to his spouse or common-law partner or to a spousal and common-law partner trust
- the taxpayer's legal representatives and the transferee have jointly executed an election in respect of the property in prescribed form T2069, "Election in Respect of Amounts Not Deductible as Reserves for the Year of Death"

If these conditions are met, the following rules apply:

- the reserve that was not otherwise deductible in computing the taxpayer's income may be deducted in the year of his death
- the reserve deducted in computing the deceased taxpayer's income must be included in computing the transferee's income for the first taxation year ending after the death of the taxpayer
- each reserve will be deemed to have been included in computing the transferee's income for a previous year and will be deemed to arise from the same source as that of the deceased taxpayer
- the transferee computes his reserve as if he were the taxpayer who had disposed of the property on the date when the taxpayer had disposed of it

Capital cost allowance

When a taxpayer dies, he is deemed to have disposed of his capital property immediately before his death. Consequently, no CCA may be claimed on the depreciable property that he owned at the time of death, since he is presumed to no longer own it at the time of death.

READING 8-2

Deemed disposition of property on death

LEVEL 1

On the death of a taxpayer, there are a number of rules whose purpose is to tax accrued gains and losses on certain property held by the taxpayer immediately before his death. The property covered by these rules is property which has been excluded from the definition of rights or things.

Firstly, this section examines the general rules applicable to different types of property; secondly, the special rules applicable to the transfer of property to a spouse or common-law partner or to a spousal and common-law partner trust are examined; and lastly, the transfer of farm property to a child is studied.

Subsections 248(8) and 248(9) contain rules to determine whether a property was acquired as a consequence of the death of a person in cases where there is a disclaimer of an estate or a release or surrender of an interest in, or rights to the property of, an estate.

These provisions state that the property transferred to a person as a consequence of an outright disclaimer of an estate by another person (as opposed to a disclaimer in favour of a specific person) is considered as property acquired as a consequence of the death. This is important for determining whether the specific provisions relating to property transferred to the spouse or common-law partner, as well as to farm property transferred to the children, apply. For example, a deceased person bequeathed under a will all her property in equal shares to her spouse and her child. The child disclaims his share of the estate and all the property comes to the spouse under the legislation applicable in the province. Under paragraph 248(8)(c), the spouse is considered as having acquired all the property as a consequence of the death of the person and the provisions relating to the transfer of property to a spouse will apply on all the property transferred to the spouse.

Capital property

Capital property is defined in section 54 as any depreciable property or any property, any gain or loss from the disposition of which would be a capital gain or capital loss. Non-depreciable capital property includes shares, land, bonds, etc.

Under paragraph 70(5)(a), a deceased taxpayer is deemed to have disposed of all the capital property owned by him immediately before his death.

For each property, he is deemed to have received POD equal to the FMV of the property immediately before his death.

The FMV of property deemed to have been disposed of on death is valued under the regular rules applicable to *inter vivos* dispositions. However, subsection 70(5.3) provides that in valuing the shares of a corporation which held an insurance policy on the life of the deceased, only the cash surrender value of the policy rather than the life insurance proceeds will be considered in determining the FMV of the shares. Consult IT-416R3 for further information. This rule also applies in valuing an interest in a partnership or trust that held a life insurance policy.

Under paragraph 70(5)(b), the deemed proceeds of disposition (DPOD) of a capital property received by a beneficiary as a consequence of the death of a taxpayer become the beneficiary's cost.

In the case of a depreciable property, when the cost of the property for the beneficiary (and thus the FMV of the property) is less than its capital cost (CC) for the deceased, the CC of the property for the beneficiary is deemed to be an amount equal to the CC for the deceased, and the excess is deemed to have been granted to the beneficiary as a deduction for CCA [paragraph 70(5)(c)].

Note that paragraph 13(7)(e), which has the effect of amending the CC for CCA purposes in transactions between persons not dealing at arm's length, does not apply where property is acquired as a result of the death of the transferor.

If the property was held on December 31, 1971, it is necessary to consider special rules that apply. According to these rules, the capital gain accumulated as of that date is not taxable.

Example 8-6 shows the tax consequences of the deemed disposition of non-depreciable capital property at FMV on the death of a taxpayer.

EXAMPLE 8-6

Grethe Burton owns land which she acquired in 1989 and which has the following attributes:

	Cost and ACB	FMV immediately before death
Land	$ 4,000	$ 20,000

Grethe died and left the land to her son Bernard.

Tax consequences

1. For Grethe:

Taxable capital gain

DPOD [70(5)(a)]	$ 20,000
ACB	(4,000)
Capital gain	$ 16,000
Taxable capital gain (1/2)	$ 8,000

2. For Bernard:

ACB of the land to her son	$ 20,000

Examples 8-7 to 8-9 show different situations in which the rules concerning deemed disposition on death apply to depreciable property. In each case, the situation dealt with is described immediately before the example.

Where FMV exceeds the capital cost of the deceased

EXAMPLE 8-7

Constantin Darius owned a depreciable property acquired in 1991 having the following characteristics:

CC	$100,000
UCC on death	$ 50,000
FMV immediately before death	$120,000

At his death in March 2008, Constantin bequeathed the property to his daughter Wendy. Wendy sold the property in December 2008 for $125,000. It is the only property in the depreciation class.

Tax consequences

1. For Constantin:

DPOD [70(5)(a)]		$120,000
Capital gain		
DPOD		$120,000
CC		(100,000)
Capital gain		$ 20,000
Taxable capital gain (1/2)		$ 10,000
Recapture of CCA		
The lesser of:		
• CC	$100,000	
• DPOD	$120,000	$ 100,000
UCC		(50,000)
Recapture of CCA		$ 50,000

2. For Wendy:

CC [70(5)(b)] $120,000

Paragraph 70(5)(c) does not apply, since the FMV of the property, which is the acquisition cost of the property for Wendy under paragraph 70(5)(b), exceeds the CC of the property for the deceased.

Capital gain		
POD		$125,000
CC		(120,000)
Capital gain		$ 5,000
Taxable capital gain (1/2)		$ 2,500
Recapture of CCA		
The lesser of:		
• CC	$120,000	
• POD	$125,000	$ 120,000
UCC		(120,000)
Recapture of CCA		$ —

Where FMV is less than the capital cost for the deceased

EXAMPLE 8-8

Assume the same facts as in the previous example, except that the depreciable property has the following characteristics:

CC	$100,000
UCC on death	$ 60,000
FMV immediately before death	$ 40,000

and Wendy sold the property for $75,000.

Tax consequences

1. For Constantin:

DPOD [70(5)(a)]	$ 40,000

Terminal loss

A terminal loss equal to the excess of the UCC over the DPOD may be deducted in the deceased taxpayer's return.

UCC	$ 60,000
DPOD	(40,000)
Terminal loss	$ 20,000

2. For Wendy:

Since the FMV of the property, which is the acquisition cost of the property for Wendy under paragraph 70(5)(b), is less than the CC of the property for Constantin, paragraph 70(5)(c) applies. Thus, the CC of the property for Constantin becomes the CC for Wendy and the difference between the CC and the FMV is deemed to be the CCA claimed by Wendy. Since this is the only property in the depreciation class after the acquisition, the UCC of the class is equal to the FMV of the property.

Acquisition cost [70(5)(b)]	$ 40,000

Application of paragraph 70(5)(c):

CC [70(5)(c)(i)]	$100,000
CCA deemed to have been claimed [70(5)(c)(ii)]	(60,000)
UCC	$ 40,000

Recapture of CCA

UCC		40,000
Less: the lesser of:		
• CC	$100,000	
• POD	$ 75,000	$ (75,000)
Recapture of CCA		$ (35,000)

There is no capital gain, since the POD are less than the CC of $100,000.

Where there is more than one property in the class

EXAMPLE 8-9

Anna Ostroff died in 2008. At the time of her death, she owned two properties included in the same depreciable class.

	Property 1	Property 2
FMV immediately before death	$ 12,000	$ 12,000
CC	$ 20,000	$ 8,000
UCC of the class	$ 10,000	

In her will, she bequeathed Property 1 to her son Ken and Property 2 to her daughter Lucie. Before they acquired the bequeathed property, Ken and Lucie owned no depreciable property.

Tax consequences

1. For Anna:

DPOD [70(5)(a)]

Property 1	$ 12,000
Property 2	$ 12,000

Recapture of CCA

	Property 1	Property 2	
UCC			$ 10,000
Less: the lesser of:			
• CC	$ 20,000	**$ 8,000**	
• DPOD	**$ 12,000**	$ 12,000	(20,000)
Recapture of CCA			($10,000)

Capital gain

Property 1: There is no capital gain because the DPOD are less than the CC.

Property 2:	DPOD	$ 12,000
	CC	(8,000)
	Capital gain	$ 4,000
	Taxable capital gain (1/2)	$ 2,000

2. For Ken — Property 1:

Paragraph 70(5)(c) applies, since the FMV of Property 1, which is the acquisition cost for Ken under paragraph 70(5)(b), is less than the CC of the property for Anna. The CC of Property 1 for Ken is therefore equal to the CC for Anna, and Ken is deemed to have claimed CCA for the difference between the CC for Anna and the FMV of the property. Since this is the only property in the depreciation class after the acquisition, the UCC of the class is equal to the FMV of the property.

Acquisition cost [70(5)(b)]	$ 12,000

Application of paragraph 70(5)(c):

CC	$ 20,000
CCA deemed to have been claimed	(8,000)
UCC	$ 12,000

3. For Lucie — Property 2:

Acquisition cost [70(5)(b)]	$ 12,000

Paragraph 70(5)(c) does not apply because the FMV of the property, which is the acquisition cost for Lucie under paragraph 70(5)(b), is greater than the CC of the property for Anna. This acquisition cost represents the CC of the property for purposes of computing both CCA and the capital gain on the subsequent sale of the property.

Eligible capital property

Under subsection 70(5.1), where a taxpayer who owns an ECP dies and the ECP is transferred to a person, other than the spouse or common-law partner of the deceased or a corporation that the deceased controlled, the deceased taxpayer is deemed to have disposed of the property immediately before his death for an amount equal to 4/3 of the CEC in respect of the business. An amount equal to 3/4 of the DPOD is deducted from the CEC, thereby reducing this amount to nil. Thus, an amount is neither included in nor is deductible from the deceased taxpayer's income.

Where there is more than one eligible capital property in the CEC, the DPOD must be allocated among the different eligible capital properties on the basis of their FMV as follows:

$$4/3 \times \text{CEC} \times \frac{\text{FMV of property}}{\text{FMV of all properties included in CEC}}$$

If no such property is transferred on death, the CEC balance may be deducted from the income of the deceased taxpayer under subsection 24(1), since the deceased is deemed to have ceased to carry on the business.

Where the beneficiary who acquires the ECP by virtue of the taxpayer's death does not continue the business, that person is deemed to have acquired a capital property at the time of the death of the taxpayer at a cost equal to the deceased taxpayer's DPOD. A subsequent disposition of the property may result in a capital gain or loss for the beneficiary.

However, if the beneficiary continues to carry on the business, the beneficiary is deemed to have acquired an ECP and to have made an eligible capital expenditure at a cost equal to the deceased taxpayer's DPOD plus 4/3 of an amount equal to the previous deductions claimed by the deceased taxpayer under paragraph 20(1)(b). This amount of deductions previously claimed by the deceased will be considered to be a deduction claimed by the beneficiary when the CEC is established, so that on the sale of the ECP, the beneficiary will be taxed on any recovery of this amount under paragraph 14(1)(a).

When all the deceased taxpayer's ECP relating to a business is transferred to the spouse or common-law partner of the deceased and the business continues to be carried on by the spouse or common-law partner, the rollover provided for in subsection 24(2) applies instead of the foregoing rules. In order to understand the tax consequences of subsection 24(2), examine paragraph 14 of IT-313R2.

If the spouse or common-law partner or the corporation does not continue to carry on the business, or if all the ECP is not transferred to either taxpayer, the foregoing general rule applies.

For more details and an example of how subsection 70(5.1) applies, examine paragraphs 18 to 22 of IT-313R2.

Resource properties and land inventories

Under subsection 70(5.2), a deceased taxpayer is deemed to have disposed of all Canadian and foreign resource properties and all land inventories at their FMV immediately before death. Therefore, the income of the deceased taxpayer in the year of death includes amounts that would have been included in his income had he disposed of his properties and land inventories at their FMV immediately before his death.

The person who acquires this property as a result of the death acquires it at its FMV.

Life insurance policies

Deceased person

Where the deceased person held life insurance policies at the time of his death, whether they are policies on his life or the life of other persons, there are no tax consequences for him if those policies were acquired before 1982 or if the policy in question is an exempt policy within the meaning of the ITA [subsection 148(9), definition of "disposition," paragraph (j)].

A life insurance policy will generally be exempt. A policy is not exempt if it is an insurance policy issued primarily for investment purposes rather than to provide protection. In case of doubt, the issuer of the policy should be consulted to determine whether the policy is exempt.

In the case of an insurance policy acquired after 1982 that is not exempt, there is a deemed disposition of the policy for an amount equal to the "accumulating fund" [paragraph 148(2)(b)]. The effect of this deemed disposition is to make taxable any gains accumulated in the policy that have not been taxed previously. The issuer of the policy should be consulted in order to determine the taxable amount, since for this purpose it is necessary to calculate the accumulating fund and the adjusted cost base of the policy, and these calculations are complex.

Exceptions to the deemed disposition rule exist where a policy is transferred to the spouse or common-law partner or where a policy is transferred to a child if that child was the person whose life was insured under the policy.

Beneficiary of the proceeds

The proceeds of any insurance policy on the life of the deceased person may be cashed by the beneficiary without tax consequences.

Bequest to a spouse, common-law partner, or a spousal or common-law partner trust

The general rules regarding the deemed disposition of the deceased taxpayer's property on death are modified where the property is transferred to a spouse, common-law partner, or to a spousal or common-law partner trust.

Under subsection 248(1), the term **common-law partner** means a person who up to the time of death, as the case may be,

- had been cohabiting with the deceased taxpayer in a conjugal relationship for at least twelve months
- cohabited with the deceased taxpayer in a conjugal relationship and is the parent of a child of the deceased taxpayer

The concept of common-law partner includes same-sex partners.

The **spousal or common-law partner trust** is defined in paragraph 70(6)(b) as being a trust, *created by the will* of the deceased, which was resident in Canada immediately after it acquired the property of the deceased and under which

- the spouse or common-law partner is entitled to receive all of the income of the trust during his or her lifetime

and

- no other person except the spouse or common-law partner may, before the spouse's or common-law partner's death, receive or otherwise obtain the use of any of the income or capital of the trust

A trust created by will that does not meet these conditions is commonly called a "tainted" spousal or common-law partner trust. Thus, where the trust provides for the settlement of various debts, obligations, and death duties out of trust property, it is a "tainted" trust. A trust can be "untainted" in certain cases; refer to subsection 70(7) and to IT-305R4 for more details.

The tax advantage of bequeathing property to a spouse, common-law partner, or spousal or common-law partner trust lies in the fact that the deemed disposition of property at FMV is deferred until the death of the spouse or common-law partner, since the property of the deceased is generally rolled over to the spouse, common-law partner or spousal or common-law partner trust, as you will see when examining the specific rules that apply to different classes of property.

Capital property

In the case of capital property, subsection 70(6) of the ITA provides for a rollover, that is a transfer, at the tax cost of the property to the spouse, common-law partner, or spousal or common-law partner trust. By virtue of the rollover, tax on the income, the capital gain or the recapture of CCA is deferred until the spouse or common-law partner either disposes of the property, dies, or ceases to be resident in Canada.

However, four conditions must be met:

- the deceased taxpayer must be resident in Canada immediately before his death;
- the spouse or common-law partner must be resident in Canada immediately before the death or, if the property is transferred to a trust, the trust must be a spousal or common-law partner trust within the meaning of paragraph 70(6)(b);
- the property transferred must be transferred following the death of a taxpayer; and
- it can be shown that the property has become vested indefeasibly in the spouse, common-law partner or trust within 36 months after the death or within such longer period as is considered reasonable in the circumstances.

An example of a situation where it must be determined whether an individual's property has vested indefeasibly is the vesting of shares subject to a buy-sell agreement. Where, under the terms of the agreement, it is compulsory for the executor to sell and the other parties to buy the shares, the shares will not be considered to vest indefeasibly in the beneficiary.

Under subsection 70(6), where capital property is transferred to the spouse, common-law partner, or spousal or common-law partner trust, the "rollover" rules apply automatically, thereby avoiding the realization of a capital gain or recapture of CCA.

Under paragraph 70(6)(d), the deceased taxpayer is deemed to have disposed of non-depreciable capital property at its ACB and depreciable property of a prescribed class at an amount equal to the lesser of

- the CC of the property

or

- the cost amount of the property immediately before death

The cost amount of depreciable property is defined in subsection 248(1) and is determined as follows:

$$\frac{\text{capital cost of the property bequeathed to the spouse}}{\text{capital cost of all property of the class in which the property is included}} \times \text{UCC of the class in which the property is included}$$

Note that, under subsection 70(14), depreciable property of a prescribed class is disposed of in the order indicated by the representative of the deceased. This designation is especially important where the property in the class is not all bequeathed to the spouse or common-law partner, or to a spousal or common-law partner trust as illustrated in Example 8-10.

EXAMPLE 8-10

Lisbett Cameron died in 2008. She owned two depreciable properties, which were included in the same prescribed class. The information regarding these properties is as follows:

	CC	**FMV immediately before death**
Property 1	$ 40,000	$ 42,000
Property 2	$ 30,000	$ 27,000

The UCC of the class that includes these properties is $35,000.

Lisbett bequeaths Property 1 to her spouse Robin and Property 2 to her son John. Neither of them owned depreciable property before they received their bequests.

Tax consequences

1. In the case where Property 1 is designated as the first property disposed of:

For Lisbett:

Recapture of CCA

UCC			$ 35,000
Less:	Disposition of Property 1		
	the lesser of: • CC	$ 40,000	
	• DPOD[1]	$ 20,000	(20,000)
			15,000
Less:	Disposition of Property 2		
	the lesser of: • CC	$ 30,000	
	• DPOD[2]	$ 27,000	(27,000)
Recapture of CCA			$ (12,000)

[1] Paragraph 70(6)(d) applies, since the property is bequeathed to the spouse. The DPOD are equal to the lesser of:

- CC — $40,000
- cost amount: $\$35,000 \times \frac{\$40,000}{\$70,000}$ — $20,000

[2] The general rule set out in paragraph 70(5)(a) applies, since the property is transferred to the son. The DPOD are equal to the FMV of the property, namely, $27,000.

For Robin (spouse):

Under paragraph 70(6)(d), the acquisition cost for Robin is deemed to be equal to the DPOD of Property 1 for Lisbett, or $20,000. Since the CC of Property 1 for Lisbett ($40,000) was greater than the acquisition cost of the property for Robin ($20,000), Robin is deemed under paragraph 70(6)(e) to have a CC for Property 1 equal to the CC for Lisbett and to have claimed CCA for the difference between the CC for Lisbett and the acquisition cost.

Acquisition cost [70(6)(d)]	$ 20,000
Application of paragraph 70(6)(e):	
CC of Property 1	$ 40,000
Deemed CCA deducted	(20,000)
UCC	$ 20,000

For John (son):

Under paragraph 70(5)(b), the DPOD of Property 2, namely the FMV of $27,000, are the acquisition cost for John. Since the CC of Property 2 for Lisbett ($30,000) was greater than the acquisition cost of the property for John ($27,000), John is deemed under paragraph 70(5)(c) to have a CC for Property 2 equal to the CC for Lisbett and to have claimed CCA for the difference between the CC for Lisbett and the acquisition cost.

Acquisition cost [70(5)(b)]	$ 27,000
Application of paragraph 70(5)(c):	
CC of Property 2	$ 30,000
Deemed CCA deducted	(3,000)
UCC	$ 27,000

2. In the case where Property 2 is designated the first property disposed of:

For Lisbett:

Recapture of depreciation

UCC			$ 35,000
Less:	Disposition of Property 2		
	the lesser of: • CC	$ 30,000	
	• DPOD[1]	$ 27,000	(27,000)
			8,000
Less:	Disposition of Property 1		
	the lesser of: • CC	$ 40,000	
	• DPOD[2]	$ 8,000	(8,000)
Recapture of CCA			$ —

[1] The general rule set out in paragraph 70(5)(a) applies, since the property is transferred to the son. The DPOD are equal to the FMV of the property, namely, $27,000.

[2] Paragraph 70(6)(d) applies, since the property is bequeathed to the spouse. The DPOD are equal to the lesser of:

- CC — $ 40,000
- cost amount: $\$8{,}000 \times \frac{\$40{,}000}{\$40{,}000}$ — $ 8,000

For Robin (spouse):

Under paragraph 70(6)(d), the acquisition cost for Robin is deemed to be equal to the DPOD of Property 1 for Lisbett, namely $8,000. Since the CC of Property 1 for Lisbett ($40,000) was greater than the acquisition cost of the property for Robin ($8,000), Robin is deemed under paragraph 70(6)(e) to have a CC for Property 1 equal to the CC for Lisbett and to have claimed CCA for the difference between the CC for Lisbett and the acquisition cost.

Acquisition cost [70(6)(d)]	$ 8,000

Application of paragraph 70(6)(e):

CC of Property 1	$ 40,000
Deemed CCA deducted	(32,000)
UCC	$ 8,000

For John (son):

Under paragraph 70(5)(b), the DPOD of Property 2, namely the FMV of $27,000, are the acquisition cost for John. Since the CC of Property 2 for Lisbett ($30,000) was greater than the acquisition cost of the property for John ($27,000), John is deemed under paragraph 70(5)(c) to have a CC for Property 2 equal to the CC for Lisbett and to have claimed CCA for the difference between the CC for Lisbett and the acquisition cost.

Acquisition cost [70(5)(b)]	$ 27,000

Application of paragraph 70(5)(c):

CC of Property 2	$ 30,000
Deemed CCA deducted	(3,000)
UCC	$ 27,000

Note that if Property 1 is designated the first property disposed of, a CCA recapture of $12,000 must be reported on the deceased's return and the spouse acquires the property at $20,000. By contrast, if Property 2 is designated as the first property disposed of, taxation of the recapture of $12,000 is deferred until the disposition of Property 1 by the spouse, since the deceased does not realize any recapture at the time of death but the spouse acquires the property for $8,000. The cost of Property 2 is not affected by the election.

In some cases it may be more advantageous not to use the rollover rules. This is the case, for example, where the deceased taxpayer had significant loss carryforwards or where he had not fully utilized his CGD on qualified property. The legal representative may elect to realize the capital gain or recapture of CCA on certain property of the taxpayer to utilize losses carried forward or the CGD. The election provided for in subsection 70(6.2) may be made for one or more properties. Where the election is made, the general rules apply to such property.

In all cases, the spouse or common-law partner is deemed to have acquired the property for an amount equal to the DPOD of the deceased taxpayer. In the case of depreciable property, where the DPOD of a property for the deceased taxpayer are less than the CC of the property, the CC of the property for the spouse or common-law partner will be equal to the CC of the property for the deceased taxpayer and the spouse or common-law partner will be deemed to have claimed the difference as CCA. Thus, on the actual disposition of the property, the spouse or common-law partner will be taxed on the recapture of CCA that was not taxed on death.

Example 8-11 shows the tax consequences, including the election under subsection 70(6.2), when capital property is transferred to the spouse or common-law partner following a death.

EXAMPLE 8-11

Izfal Singh died in December 2008. He owned the following property at the time of his death, all of which was acquired after 1971:

	UCC	Cost	FMV
3,000 shares of private corporation Patino Inc.*	—	$300,000	$ 2,550,000
Rental property acquired in March 1982			
• land	—	$ 20,000	$ 60,000
• building	$ 55,000	$ 75,000	$ 150,000

* These shares are qualified small business corporation shares.

In his will, Izfal bequeathed all his property to his common-law partner, Khaja. Izfal had never claimed the CGD and had no loss carryovers.

Tax consequences

1. For Izfal:

   Under subsection 70(6), the DPOD on death are equal to the cost amount of the property.

• shares of private corporation Patino Inc.	$300,000
• land	$ 20,000
• building	$ 55,000

   Consequently, there are no tax consequences for Izfal on his death.

2. For Khaja:

The acquisition cost of the property would be:

• shares of private corporation Patino Inc.	$300,000
• land	$ 20,000
• building: CC	$ 75,000
CCA deemed to have been deducted	(20,000)
UCC	$ 55,000

3. Subsection 70(6.2) election for certain property:

Given that Izfal has never claimed the CGD, it would be advantageous to make the election under subsection 70(6.2) for the shares of Patino Inc. to create a capital gain sufficient to use the CGD on qualified small business corporation shares.

Election on 1,000 shares of private corporation Patino Inc.:

Capital gain

DPOD (1,000 shares × $850)	$ 850,000
ACB (1,000 shares × $100)	(100,000)
Capital gain	$ 750,000
Taxable capital gain (1/2)	$ 375,000
CGD	(375,000)
Taxable amount	$ —

The rollover under subsection 70(6) would apply to the other property.

The acquisition cost of the property for Khaja would be:

• shares of Patino Inc.	
2,000 shares × $100	$ 200,000
1,000 shares × $600	600,000
3,000 shares	$ 800,000
• land	$ 20,000
• building: CC	$ 75,000
CCA deemed to have been deducted	(20,000)
UCC	$ 55,000

Thus, on the subsequent disposition of the shares, Khaja will realize a lower capital gain because the ACB of the shares will be greater.

Resource properties and land inventories

Under subsection 70(5.2), where a resource property is transferred to a spouse, common-law partner, or spousal or common-law partner trust and the four conditions listed above for capital property are met, the executor may specify as the DPOD of the resource property any amount not exceeding the FMV of the property. The cost of acquisition of the property for the spouse, common-law partner, or spousal or common-law partner trust will generally be equal to the DPOD for the deceased.

In the case of land inventories, subsection 70(5.2) provides for a rollover equal to the cost amount where the land is transferred to a spouse, common-law partner, or spousal or common-law partner trust and the four conditions listed above are met.

LEVEL 2

Bequest of farm or fishing property to a child

Another exception to the general rule occurs where farm or fishing property is transferred by a farmer or fisher to one or more of his children. Subsection 70(10) stipulates that the term "child" includes a grandchild, a great grandchild, and a person who at any time before he attained the age of 19 years, was wholly dependent on the taxpayer for support and of whom the taxpayer had the custody at that time, in law or in fact. Furthermore, under section 252, the following are considered to be a child of the taxpayer: the spouse or common-law partner of a child of the taxpayer as well as a child of the spouse or common-law partner of the taxpayer.

Under subsection 90(9), the property covered by this exception is land and depreciable property that was, immediately before death, used in the course of carrying on the business of farming or fishing in which the deceased taxpayer, his spouse or common-law partner, or one of his children was actively engaged on a regular and continuous basis. The exception also applies to property used in a woodlot operation in which the deceased taxpayer, his spouse or common-law partner, or one of his children took part to the extent required by a prescribed forest management plan.

In order for the exception to apply, the qualifying farm or fishing property must be transferred to a child resident in Canada and must have become vested indefeasibly in the child within 36 months after the date of death or such longer period as is considered to be reasonable on written application made by the deceased taxpayer's legal representative.

Under subsection 70(9.01), in computing the DPOD on death of any qualifying property transmitted to a child, the deceased taxpayer's legal representative may elect a value that is different from FMV. The elected amount may be any value between the following limits:

Land:
- ACB immediately before death
- FMV immediately before death

Depreciable property:
- the lesser of the CC of the property or the cost amount of the property immediately before death
- the FMV of the property immediately before death

The child is deemed to have acquired each property for an amount equal to the POD elected by the legal representative. In the case of depreciable property, where the original CC of the property is higher than the DPOD of the property, the CC of the property for the child is deemed to be equal to the CC for the deceased taxpayer, and the excess is deemed to have been allowed to the child as a deduction for CCA.

Under subsections 70(9.2) and (9.21), a similar election, for a value between ACB and FMV, is available for transfers of shares of a family farm or fishing corporation to a child.

Under subsections 70(9.2) and (9.21) in the case of an interest in a family farm or fishing partnership transferred to a child,

1. the deceased is not deemed to have disposed of the interest before his death except for purposes of paragraph 98(5)(g);
2. the child takes the parent's place for tax purposes, that is, the cost of the parent's interest becomes his cost and all adjustments provided for in subsections 53(1) and 53(2) applicable to the parent's interest are deemed to be those of the child.

"Share of the capital stock of a family farm corporation," "share of the capital stock of a family fishing corporation," "interest in a family farm partnership," and "interest in a family fishing partnership" are defined in subsection 70(10).

Lastly, under subsections 70(9.1), 70(9.11), 70(9.3), and 70(9.31), similar elections are available where farm property, shares of a family farm or fishing corporation, or an interest in a family farm or fishing partnership are first transferred to a spousal or common-law partner trust and then, on the death of the spouse or common-law partner, from the spousal or common-law partner trust to a child.

You man want to read IT-349R3, which discusses and explains situations where farm property is transferred to children following the death of a taxpayer. However, several changes were made to the rules in 2006, and therefore some parts of the bulletin are no longer current. Note that the bulletin deals only with farm businesses; only starting on May 2, 2006 do the rules cover fishing businesses. Also, the rules on transferring an interest in a family partnership have been changed.

READING 8-3

Deferred income plans

LEVEL 1

Registered retirement savings plan

When the holder of a registered retirement savings plan (RRSP) dies, the FMV of the property in his plan at the time of his death must be included in computing his income under subsection 146(8.8).

Spouse or common-law partner

When a spouse or common-law partner is the beneficiary of an RRSP, a particular tax treatment applies. The treatment will be slightly different depending on whether or not the plan has matured. The maturation of an RRSP occurs on the date set under the plan for retirement income to begin. The maturation of an RRSP must occur no later than December 31 of the year during which the annuitant reaches age 69.

Unmatured plan

When the spouse or common-law partner is validly designated as the beneficiary of the plan, either in the plan itself or by will, the value of the property in the RRSP accruing to the spouse or common-law partner (called "refund of premiums") may be excluded from the income of the deceased person and is included in the spouse's or common-law partner's income. When the spouse or common-law partner is not explicitly designated as the beneficiary of the RRSP, either in the plan itself or in the will, but the spouse or common-law partner is entitled, under the terms of the will, to a total legacy, excluding the bequest of specific property, equal to or greater than the RRSP, it is possible to designate the spouse or common-law partner as the beneficiary of the plan by filing Form T2019 in order to take advantage of the rollover to the spouse or common-law partner [146(8), 146(8.1), 146(8.8), 146(8.9), and the definitions of "benefit" and "refund of premiums" in subsection 146(1)].

According to the procedure provided for in the ITA, the FMV of the property must be included in the deceased person's income, and then the refund of premiums to which the spouse or common-law partner is entitled can be deducted ***in whole or in part***. The spouse or common-law partner must include in his income the amount deducted in the deceased person's return. Because of this freedom to redistribute the amount normally taxable in the deceased person's income, there is an opportunity to plan how to pay the least tax possible considering the level of taxable income of each of the spouses. But the option of deferring tax should also be considered if the spouse or common-law partner has no immediate need for money.

If the RRSP has not matured, the amount added to the income of the spouse or common-law partner may be transferred from the deceased person's RRSP to his own RRSP or RRIF under paragraph 60(l), thereby deferring any taxes on the amounts transferred until the funds are received by the spouse or common-law partner. The spouse or common-law partner may also defer taxation by purchasing a qualified annuity provided for in paragraph 60(l).

Matured plan

In the case of a matured RRSP of which the spouse or common-law partner becomes the beneficiary following a designation made by the deceased taxpayer on subscribing to the plan, the spouse or common-law partner is taxed on the benefits when received rather than on the value of the accumulated funds. However, if the annuity is converted into a lump-sum payment, the spouse or common-law partner can defer taxation of it by transferring the

amount to his RRSP or RRIF, or by purchasing an eligible annuity provided for in paragraph 60(l).

Where the spouse or common-law partner is not explicitly designated as the beneficiary of the RRSP in the plan, an election can be made to designate him as the beneficiary of the plan where the will provides that he is entitled to any amounts paid from the plan. Unlike where the plan has not matured, in which case a prescribed form is required, the designation is done by filing a letter, with one copy to be sent to the payer of the annuity and another attached to the return of the spouse or common-law partner [subsection 146(8.91)].

Financially dependent child or grandchild

There is a second exception to the general rule where the RRSP is paid to a child or grandchild financially dependent on the deceased person.

A child is deemed not to be financially dependent on the annuitant for support if the child's income for the taxation year preceding the year of death of the annuitant exceeds the amount used in computing the basic personal tax credit for that preceding taxation year (the basic personal amount is $9,600 for 2008, $9,600 for 2007). In the case of a child or grandchild financially dependent because of physical or mental impairment, this income threshold is increased by an indexed amount annually ($7,021 in 2008 for a total amount of $16,621 in 2008, and $6,890 in 2007 for a total amount of $16,490 in 2007). So, in the case of a child physically or mentally impaired, if the parent died in 2008, the income of the child for 2007 would have to be lower than $16,490. These presumptions may be rebutted by submitting evidence to the contrary [subsection 146(1.1)].

As in the case of the spouse or common-law partner, even if the child or grandchild is not explicitly the beneficiary of the RRSP, it is possible to designate him as such by filing Form T2019 if, under the terms of the will, he is entitled to a total legacy equal to or greater than the RRSP.

The amount paid to a financially dependent child or grandchild [called refund of premiums] may be included in computing the recipient's income rather than the deceased's income [subsection 146(8.9) and the definitions of "benefit" and "refund of premiums" in subsection 146(1)].

Under subsection 60(l), if the child or grandchild is dependent by reason of physical or mental infirmity, he may transfer the taxable amount received to his own RRSP thereby deferring tax on the amount until the funds are received from the RRSP. If the child or grandchild is under 18 years of age, the amount may be brought into income over a number of years if an annuity is purchased for a term of years not exceeding 18 minus the age of the dependent at the time the annuity is purchased [paragraph 60(l)].

Read CRA guide RC4177 for further details on taxation of an RRSP at death.

Registered retirement income fund

The rules on the taxation of registered retirement income funds (RRIFs) at death are basically the same as for RRSP.

Thus, under subsection 146.3(6), unless the spouse or common-law partner or a dependent child or grandchild is designated as the beneficiary, the FMV of the property in the plan at the time of death must be included in the income of the deceased person.

The "rollover" to the spouse or common-law partner or a dependent child or grandchild provided for in the case of an RRSP also applies in the case of an RRIF. However, where the spouse, common-law partner, or dependent child or grandchild is not specifically designated

as a beneficiary of the plan in the plan itself or in the will, the designation by legal representatives and the beneficiary is made on Form T1090 rather than on Form T2019. [146.3(6.1), 146.3(6.11), 146.3(6.2), and the definition of "designated benefit" in 146.3(1)]

Registered pension plan

If a taxpayer is a member of a registered pension plan (RPP), on his death, the designated beneficiaries will be taxed on the funds from this plan under subparagraph 56(1)(a)(i). If there is no designated beneficiary, the estate, in its capacity as a beneficiary, must be taxed on these amounts. A spouse or common-law partner may defer tax on the amounts received by transferring them to his spouse's or common-law partner's own RRSP or RRIF under subsection 147.3(7). In the case of a child or grandchild under 18 years of age, the amounts may, under paragraph 60(l), be brought into income over a number of years if an annuity is purchased for a fixed number of years not exceeding 18 minus the age of the child or grandchild at the time the annuity is purchased.

Note that a child or grandchild need not be "dependent" on the deceased taxpayer to be taxed on the amount of the RPP as it is in the case for the RRSP. Also, note that a child or grandchild who is physically or mentally impaired and "financially dependent" on the deceased person may not transfer the amount received to his own RRSP as it is possible for the RRSP taxed in the hands of a child or grandchild dependent by reason of physical or mental infirmity.

Profit sharing plan

If the deceased taxpayer is a member of a deferred profit sharing plan (DPSP) at the time of his death, the beneficiaries will be taxed on the funds from the plan under subsection 147(10). If the spouse or common-law partner is the beneficiary of the DPSP, taxes may be deferred under subsection 147(19) by transferring the funds to an RPP, a DPSP, an RRSP or an RRIF of which he is a beneficiary.

READING 8-5

Deductions, tax credits, and alternative minimum tax

LEVEL 2

Net capital losses

Under subsection 111(2), net capital losses incurred in the year of death or carried over from preceding years may be deducted from the deceased taxpayer's other income in the year of death and in the preceding taxation year to the extent that they exceed the total CGD previously claimed. The wording of subsection 111(2) is very confusing because it refers to and modifies other provisions of the ITA. Also, the capital gains inclusion rate has varied over the years, and adjustments are sometimes required. Examples 8-12 and 8-13 show how this rule applies when the capital loss is from a taxation year for which the inclusion rate for capital gains is 3/4.

EXAMPLE 8-12

Arielle Lafortune died in 2009. At the time of death, she had a net capital loss of $28,000 which was incurred in 1998. In 1992 and 1993, Arielle realized the following taxable capital gains against which she claimed the CGD rather than using her net capital loss to offset the gain.

1992	$ 10,000
1993	$ 5,000

In 2008 and 2009, Arielle did not realize any capital gain and her income from other sources was:

2008	$100,000
2009	$ 5,000

Tax consequences

For Arielle:

Net capital loss deductible from other income under subsection 111(2)

Net capital loss from 1997	$ 28,000
CGD claimed in 1992 and 1993	(15,000)
	$ 13,000

This amount of $13,000 may be deducted from Arielle's income from all sources for 2008 or 2009. In the present case it would be preferable to claim the deduction in 2008, when Arielle has a very large income. This will enable her to reduce the amount of income taxed at the highest rate in 2008 and to benefit from personal tax credits in 2009.

EXAMPLE 8-13

Use the same data as in Example 8-12, but now assume that in 2009 Arielle has net taxable capital gains under paragraph 3(b) of $6,000 and income of $80,000 from other sources.

Tax consequences

2009

Under subsections 111(1.1) and 111(2), the capital loss for 1997 may be claimed as follows:

The total of:

1.	The lesser of [111(1.1)(a)]:		
	• net capital gains under 3(b)	$ 6,000	
	• $\$28,000 \times \frac{1/2}{3/4}$	$ 18,667	$ 6,000
2.	Net capital loss for 1997 [111(1.1)(b) as modified by 111(2)(b)]	$ 28,000	
	Less:		
	• amount claimed for 2009 according to calculation in (1) re-established in terms of inclusion of 3/4	(9,000)	
	• amount claimed as CGD in 1992 and 1993	(15,000)	4,000
Total deduction for 2009			$ 10,000

In the present case, because Arielle has a sizable income from other sources in 2009, she can claim the loss in 2009, which would make it unnecessary to amend her 2008 return. However, since Arielle realized a capital gain in 2009, the total amount deductible, according to the calculations called for in subsections 111(1.1) and (2), is limited to $10,000, whereas if a decision is made to apply the 1997 loss to the year 2008 in which no capital gain is reported, the allowable deduction would be $13,000 as calculated in Example 8-12.

Medical expenses

Generally, a tax credit may be claimed for medical expenses paid in a 12-month period ending in the year to the extent that they exceed the lesser of 3% of net income and $1,962 (in 2008). In the year of death, a tax credit may be claimed for medical expenses paid during a 24-month period that includes the date of death to the extent that they exceed the lesser of 3% of net income reported in all returns filed for the year of death or $1,962 and provided that they have not been previously claimed [subsection 118.2(1)].

Gifts

Under subsection 118.1(5), gifts made by will are deemed to be gifts made in the year of death. This presumption applies to all qualifying gifts: charitable gifts, Crown gifts, gifts of cultural property, and ecological gifts. A tax credit may therefore be claimed in the deceased taxpayer's regular return (or in one of the separate returns, as the case may be).

For charitable gifts, the regular limit of 75% of net income does not apply when computing the tax credit for the year of death [subsection 118.1(1): subparagraph (a)(ii) of the definition of "total gifts"].

Lastly, under subsection 118.1(4), gifts that were not deducted in the year of death may be carried back to the preceding year, once again without regard to the limit of 75% of net income for charitable gifts.

In summary, the tax credit may be claimed for gifts, made during the taxpayer's lifetime or by will, of up to 100% of income in the year of death and the preceding year.

Alternative minimum tax

There is no alternative minimum tax (AMT) in the year of death [127.55(a)]. However, AMT paid in a prior year can still be applied to reduce tax on the regular return, but not on the separate returns for rights or things, business income, or income from a testamentary trust [subsection 120.2(4)].

READING 8-6

Filing of income tax and benefit returns and payment of income tax

LEVEL 1

Date for filing income tax and benefit returns

Under paragraphs 150(1)(b) and (d), the regular *return for the year of death* is due on the later of the following dates:

- six months after the date of death

or

- the day on which the return should normally be filed, namely April 30 of the year following death or June 15 if the deceased carried on a business during the year

Thus, if people die between January 1 and October 31 of a year, the due date for filing their return for the year of death is April 30 of the following year if they did not carry on a business and June 15 if they did. If the death occurs between November 1 and December 31, the tax return of people who did not carry on a business for the year of death must be filed no later than six months after the date of death. In the case of people who carried on a business during the year of death, they cannot take advantage of the six-month period unless the death occurs after December 15, since June 15 would otherwise be the latest date on which the return may be filed.

If death occurs between January 1 and the usual filing date, under paragraph 150(1)(b) the *return for the taxation year preceding the death* must be filed no later than six months after the day of death. If death occurs after the usual filing date, no additional time is allowed for filing the return for the year preceding the death, since that return had to be filed prior to the date of death.

Interest on the unpaid tax for the year of death is accrued starting from

- April 30 of the year following the death, if the death occurs between January 1 and October 31

or

- the day that falls six months after the death if the death occurs between November 1 and December 31

Furthermore, in the event that death occurs before May 1, interest on the unpaid tax for the preceding taxation year accrues from the day that falls six months after the death.

Where there is a spousal or common-law partner trust and where testamentary debts must be paid from this trust, the regular return for the year of death is due 18 months after the date of death under paragraph 70(7)(a). The additional time period is allowed in order to give trustees time to determine which assets will be used to pay the debts. Interest is accrued starting from the later of six months after the date of death or April 30 of the year following death.

The separate return for income from "rights or things" is due on the later of

- one year after the date of death

or

- 90 days after the date of mailing of any notice of assessment in respect of the income tax payable by the taxpayer for the year of death [subsection 70(2)]

The separate return for business or partnership income is due on the later of

- six months after the date of death

or

- June 15 of the year following death

The separate return for income from a testamentary trust is due on the later of

- six months after the date of death

or

- April 30 of the year following death

For the three separate returns, interest on unpaid tax accrues starting from April 30 of the year following death if the death occurs between January 1 and October 31 and starting from the day that falls six months after death if the death occurs between November 1 and December 31.

Any returns not filed by the deceased for a year previous to the year of death are considered late returns for purposes of computing interest and late filing penalties, except for the return for the taxation year preceding death where death occurs between January 1 and the usual filing date, since paragraph 150(1)(b) provides for a special time limit for filing.

Payment of income tax

The income taxes on death relating to certain sources of income may be paid in instalments provided the legal representatives make the election (Form T2075) and provide acceptable security. The security may be the property of the deceased taxpayer or from a third party.

A maximum of 10 equal and consecutive annual instalments is authorized. Interest at the prescribed rate is computed on the deferred tax balance starting on the day it became payable.

Under subsections 159(5) and 159(5.1), the tax on the following income is eligible for this tax relief:

- rights or things
- recapture of CCA, the excess of capital gains over capital losses, and other income from the deemed disposition of capital property, resource property and land inventory

Under REG 1001, the election must be filed on or before the day on which payment of the first of the instalments is required to be made.

Clearance certificate

To avoid personal liability, every executor of an estate, before liquidating or transferring any property of a deceased taxpayer, must obtain a certificate from CRA certifying that all income taxes, interest, and penalties payable have been paid. These rules are contained in subsections 159(2) and 159(3).

Any transfer of property without the certificate renders the executor liable for the unpaid income taxes, interest and penalties, to the extent of the value of the property distributed.

However, CRA will issue a clearance certificate even if the income taxes are not paid in full provided that security, in the form of a mortgage or other charge against the property of the deceased taxpayer or another person or security of any other person, is provided. Refer to IC 82-6R6 for more details on the need to obtain a clearance certificate. The procedure for requesting a clearance certificate has been to file the prescribed Form TX19, "Asking for a Clearance Certificate."

READING 8-7

Capital losses realized by the estate

LEVEL 1

During the period in which a taxpayer's estate is being settled, the property of the deceased is under the control and administration of the executors. From a taxation standpoint, so long as the estate is not settled, it is treated as a trust.

As a general rule, the taxpayer's estate is deemed to have acquired the capital property of the deceased taxpayer at its FMV on death, except for the capital property that was the object of the rollover to the spouse or common-law partner or the rollover of farm property to the children. On the subsequent sale of the property, while that property is still under the control of the executors, the estate may realize a capital gain, a capital loss or a terminal loss.

If the sale takes place in the estate's first taxation year and a capital loss or terminal loss is realized, the estate's legal representatives may elect to treat the losses as if they had been incurred by the deceased taxpayer in his last taxation year [subsection 164(6)].

Such losses may be claimed against the deceased taxpayer's income in the year of death only.

Only the excess of the estate's capital losses over its capital gains in the first taxation year are eligible for the election. With respect to a terminal loss incurred by the estate, the election may be made only to the extent of the total of the estate's farm losses and non-capital losses for its first taxation year if no election had been made. In other words, a terminal loss incurred by the estate may be deducted from the income of the deceased person only if such terminal loss gives rise to or increases the farm loss or the estate's non-capital loss. If the income of the estate for its first taxation year is sufficient to absorb the terminal loss, a subsection 164(6) election cannot be made.

The carryback of the estate's loss against the deceased taxpayer's income will reduce the deceased taxpayer's tax liability.

Example 8-14 shows how an election under subsection 164(6) operates.

EXAMPLE 8-14

On his death, Carl Martin owned the following property:

	Land	Shares
ACB	$ 18,000	$ 10,000
FMV immediately before death	$ 50,000	$ 14,000

During the estate's first taxation year, the property was sold for:

	Land	Shares
POD	$ 54,000	$ 2,000

Tax consequences

1. For Carl:

   For Carl the property is deemed to be disposed of upon death as follows:

	Land	Shares
POD	$ 50,000	$ 14,000
ACB	(18,000)	(10,000)
Capital gain	$ 32,000	$ 4,000
Taxable capital gain (1/2)	$ 16,000	$ 2,000

2. For the estate:

   Capital gain or loss on disposition

	Land	Shares
POD	$ 54,000	$ 2,000
ACB	(50,000)	(14,000)
Capital gain (loss)	$ 4,000	$ (12,000)
Taxable capital gain (loss) (1/2)	$ 2,000	$ (6,000)

If the appropriate election is made, the net capital loss of $4,000 ($6,000 – $2,000) may be deducted against Carl's taxable capital gains for the year of death.

Note that the deduction of capital losses is not limited to the amount of capital gains in the year of death. Since these capital losses are deemed to be capital losses of the deceased person, the rules on capital losses unused at the time of death apply. Thus, these losses can be deducted from income from all sources for the year of death. However, they cannot be deducted from income from all sources for the previous year because of the restriction in paragraph 164(6)(f).

Under REG 1000(1), to make the election, the legal representative must file

- a letter specifying the part of the capital losses or the terminal loss that he wishes to transfer to the deceased taxpayer
- if capital losses are transferred, a schedule of the capital losses and capital gains of the estate for its first taxation year
- if a terminal loss is transferred,
  - a schedule of the UCC for the classes in which there is a terminal loss
  - a statement showing the non-capital loss or the farm loss of the estate for the year that would have resulted had the election under subsection 164(6) not been made

Under paragraph 164(6)(e), the legal representative must also file an amended return for the deceased taxpayer.

Under REG 1000(2), the election must be filed no later than the last day for filing the deceased taxpayer's income tax and benefit return or on the day the tax and benefit return for the first taxation year of the estate is to be filed.

Death of the shareholder of a private corporation

LEVEL 1

The death of the shareholder of a private corporation poses special problems when preparing the deceased shareholder's income tax and benefit return and subsequently for the estate and the heirs.

Valuation

The first problem is to determine the FMV of the shares of the private corporation for purposes of determining the capital gain resulting from the deemed disposition of the shares on death. Unlike the shares of listed public corporations, for which the value may be determined by consulting the securities listings on the date of death, the FMV of the shares of a private corporation must be determined according to a recognized valuation method. It is common knowledge that these methods do not yield a precise value. Consequently, this value may be disputed by CRA if the method or the parameters used to apply the method are not considered appropriate. To learn about CRA's policy regarding the valuation of shares, read IC 89-3.

When you read paragraphs 28 and 29 of IC 89-3, you will note that when a private corporation has more than one shareholder and those shareholders have entered into a shareholders' agreement, setting out the rules for the purchase or redemption of the shares of a deceased shareholder, the value fixed in the agreement for such a purchase or redemption may be recognized as being the FMV if certain conditions are met. Among other things, the agreement between shareholders must be a *bona fide* business arrangement and not a way to reduce the tax consequences on death.

In closing, it is important to keep in mind the provisions of subsection 70(5.3) which stipulate that for the purposes of determining the FMV of the shares of a corporation that holds a life insurance policy, it is necessary to consider the surrender value of the policy, and not the amount of capital insured.

Capital gains deduction

Generally, in order to claim the capital gains deduction (CGD) with respect to the shares of a corporation, the corporation must be an SBC at the time of disposition of the shares. Under paragraph 110.6(14)(g), in case of death, it is sufficient for the corporation to have been an SBC at some point in the 12-month period preceding death. This relief is granted because, unlike a disposition during the deceased's lifetime, the deceased person may not have had the opportunity to "purify" the corporation before the disposition in order to qualify it as an SBC.

It is necessary to satisfy the other qualifying criteria, such as holding the shares for at least 24 months and the requirement that more than 50% of the assets of the corporation, valued at their FMV, be used in a business actively carried on in Canada or be shares or debts of qualified connected corporations during the 24 months preceding the disposition.

Rollover to spouse or common-law partner

As stated in the section dealing with the rollover to the spouse or common-law partner or to a spousal or common-law partner trust, the spouse or common-law partner or the spousal or common-law partner trust must have irrevocably acquired the shares in the 36 months following death in order for the rollover to apply.

Where the deceased shareholder was not the sole shareholder of the corporation, it is possible for there to be a shareholders' agreement that stipulates that the estate must sell the shares to the surviving shareholders or that the corporation will redeem the shares within a specified time period. In such a case, even if the spouse or common-law partner is the sole beneficiary of the estate, the shares will not have vested indefeasibly in the spouse or common-law partner, and a rollover is not possible.

Sale or redemption of shares after death

Sometimes the sale or redemption of the shares after death has unexpected consequences for the estate or heirs, but these consequences can sometimes be avoided with adequate planning.

Sale of shares to a third party

The ACB of the shares for the estate or heirs is equal to the DPOD of the deceased shareholder, and therefore the capital gain or loss realized on the sale of the shares will not give rise to double taxation. However, it should be noted that if the shares are transferred to a corporation with which the estate or heir does not deal at arm's length, the provisions of section 84.1 may apply. Thus, if the CGD was claimed against the capital gain realized by the deceased person, the ACB of the shares for the purposes of section 84.1 is reduced by the amount of the capital gain that was exempted. This can trigger a deemed dividend or a reduction in the PUC, depending on the nature of the consideration received from the corporation to which the shares were transferred.

Redemption of the shares by the corporation or winding-up of the corporation

The PUC of the shares held by the estate or heirs is not altered following the death of the shareholder. Therefore, when the issuing corporation redeems or purchases the shares, or when the corporation is wound up, a deemed dividend may result, as illustrated by Example 8-15.

EXAMPLE 8-15

In 1994, Jean Lafleur subscribed to 1,000 shares of Floralie Inc. for $10,000. Jean died in November 2006, when the 1,000 shares were worth $100,000. His daughter Rose was the sole beneficiary of his estate. Jean's estate was liquidated in 2007, and the shares were given to Rose. Floralie Inc. redeemed the 1,000 shares in December 2008 for $100,000.

Floralie Inc. has never qualified as an SBC. Floralie Inc. is a CCPC whose GRIP is nil.

Following the redemption, Floralie Inc. is controlled by persons dealing at arm's length with Rose.

Tax consequences

1. For Jean on his death — 2006:

   Deemed disposition of the 1,000 shares of Floralie Inc. [70(5)(a)]

DPOD – FMV	$100,000
ACB	(10,000)
Capital gain	$ 90,000
Taxable capital gain (1/2)	$ 45,000

   Since Floralie Inc. was never an SBC, no CGD can be claimed on the disposition of its shares.

2. For Rose on redemption of the 1,000 shares — 2008:

Deemed dividend [84(3)]

Amount paid	$100,000
PUC of the 1,000 shares of Floralie Inc.	(10,000)
Deemed dividend	$ 90,000
Grossed-up dividend to be included in Rose's income [82(1)(b)(i)]	$112,500

Capital gain

POD [54]		
Amount paid	$100,000	
Deemed dividend [84(3)]	(90,000)	$ 10,000
ACB [70(5)(b)]		(100,000)
Capital loss		$ (90,000)
Allowable capital loss (1/2)		$ (45,000)

Since Floralie Inc. is not an SBC, the capital loss cannot be a business investment loss (BIL), and it can only be claimed against capital gains realized during the previous three years or indefinitely in the future. Thus, Rose may not be able to use the loss for a number of years.

Before concluding that a capital loss on the redemption or purchase of the shares by the corporation or on the winding-up of the corporation is deductible, it is necessary to consider the application of subsection 40(3.6) and paragraph 112(3)(a).

Under subsection 40(3.6), if the corporation is affiliated with the heir or the estate after the redemption or purchase — for example, if the heir holds other shares of the corporation and controls it — the capital loss is deemed nil and is added to the ACB of the shares that the heir still holds. If the heir holds no other shares — for example, if he is affiliated with the corporation because his spouse or common-law partner controls it — the loss can never be recovered. In Example 8-15, the loss is not deemed to be nil under subsection 40(3.6) since Rose is not affiliated with Floralie Inc. after the redemption. She no longer holds shares of the corporation, and the corporation is controlled by persons dealing with her at arm's length after the redemption.

When the loss is incurred by an estate affiliated with the corporation during its first taxation year and an election under subsection 164(6) is made so that this loss, or a part of it, can be considered as being that of the deceased person, subsection 40(3.6) does not apply to the amount of the loss covered by the election.

Under paragraph 112(3)(a), if an individual has received a dividend from the CDA on the shares of a corporation, the loss realized on the disposition of the shares is reduced by the lesser of

- the total dividends on the CDA received on the shares
- the amount of the capital loss minus all taxable dividends received on the shares

Under subsection 112(3.2), a similar rule exists where a trust disposes of a share. However, if the trust is in fact an estate and the capital loss is realized in the first year of the estate, the reduction will, at most, be equal to half the capital loss.

Transactions to consider in reducing the possibility of double taxation in the case of redemption or winding-up

As you have seen, when a private corporation redeems or purchases the shares of the estate or the heirs, this results in an immediate deemed dividend and a capital loss that likely cannot be used before a number of years have passed. Consequently, there is a form of double taxation, with the capital gain taxed on the death of the shareholder and the deemed dividend on the redemption or purchase of the shares by the corporation. The same consequence may result from the winding-up of the corporation following the death of the shareholder. However, it is possible to minimize or avoid the problem by carrying out adequate planning.

Eliminating the capital gain of the deceased by using the provisions of subsection 164(6)

According to this planning approach, it is necessary to have the estate of the deceased shareholder undergo a capital loss on the shares during the first taxation year of the estate so that the loss can be applied against the capital gain reported by the deceased shareholder by making the election provided for in subsection 164(6). Thus, in the case of, say, an investment corporation, the corporation can be wound up. In other cases, winding up the corporation will not be a viable strategy. This will be the case, for example, if it is considered desirable to continue the business carried on by the corporation. In that event the redemption or purchase of the shares by the corporation may be considered. In this case, it should be kept in mind that the capital loss may be deemed nil under subsection 40(3.6) if all the shares held by the estate are not redeemed and the corporation is affiliated with the estate after the redemption. Attention should also be given to subsection 112(3.2) if the estate has received a dividend on the CDA with respect to the shares.

Example 8-16 illustrates the planning for using a capital loss on a share redemption to reduce the capital gain of the deceased.

EXAMPLE 8-16

Return to Example 8-15. This time, assume that following discussions with the other shareholders of Floralie Inc., the share redemption took place in 2007, at a time when the estate still held the shares and during its first fiscal period. In such a case, the deductible capital loss on the disposition of the redeemed shares, to the extent that it exceeds any taxable capital gain of the estate during its first fiscal period, can be claimed on Jean's final return if the election under subsection 164(6) is made.

Transfer of shares to a related corporation

When the above strategy is not viable, it is possible for the heir to receive the ACB of the shares without incurring additional tax consequences for himself by transferring the shares to a related corporation. In consideration of the transfer, he receives a note corresponding to the ACB of the shares. If the inherited shares have increased in value, shares will be issued for an amount equal to that increase and the election in subsection 85(1) will be made so that the transfer will take place with no immediate tax consequence.

This transfer will be subject to the provisions of subsection 84.1(1). However, according to that subsection, there is no immediate tax consequence provided that the note does not exceed the ACB of the inherited shares. However, it is necessary to make sure that the ACB is not changed by the effect of paragraph 84.1(2)(a.1). This is the case, for example, when the CGD has been claimed against the taxable capital gain reported by the deceased shareholder.

Example 8-17 illustrates this planning approach.

EXAMPLE 8-17

Sara Karadis died in December 2006. At that time, she held 40% and her spouse held 60% of the issued and outstanding shares of Patrimonius Inc., a corporation carrying on a real estate rental business whose income is considered as investment income. The 4,000 shares that Sara held had the following characteristics on her death:

FMV	$ 500,000
ACB	$ 40,000
PUC	$ 40,000

In her will, Sara bequeathed the 4,000 shares of Patrimonius Inc. to her daughter Sonia. In November 2007, Sonia transferred the inherited 4,000 shares to Sonia Holding Inc., a newly created corporation of which she is the sole shareholder. At the time of the transfer, the 4,000 shares of Patrimonius Inc. had an FMV of $600,000. In consideration of the transfer, Sonia Holding Inc. issued Sonia a $500,000 note and preferred shares for $100,000. The election in subsection 85(1) was made, and the agreed amount was set at $500,000.

In October 2008, Patrimonius Inc. purchased the 4,000 shares held by Sonia Holding Inc. for $600,000. Sonia Holding Inc. immediately paid off the $500,000 note held by Sonia.

Sonia's father remains the sole shareholder of Patrimonius Inc. following the purchase of the 4,000 shares.

Tax consequences

1. For Sara on her death — 2006:

Deemed disposition of the 4,000 shares of Patrimonius Inc. [70(5)(a)]

DPOD – FMV	$ 500,000
ACB	(40,000)
Capital gain	$ 460,000
Taxable capital gain (1/2)	$ 230,000

The shares of Patrimonius Inc. are not qualified small business corporation shares, since Patrimonius Inc. is not carrying on an active business. Therefore the CGD cannot be claimed.

2. On the rollover of the 4,000 shares to Sonia Holding Inc. — 2007

For Sonia:

Capital gain on the disposition of the 4,000 shares to Sonia Holding Inc.

POD — agreed amount [85(1)(a)]	$ 500,000
ACB [70(5)(b)]	(500,000)
Capital gain	$ —
ACB of the note of Sonia Holding Inc. [85(1)(f)]	$ 500,000
ACB of the preferred shares of Sonia Holding Inc. [85(1)(g)]	$ —

PUC of the preferred shares of Sonia Holding Inc.

Legal PUC of the preferred shares	$ 100,000

Reduction of the PUC [84.1(1)(a)]

(A – B) × C ÷ A

($100,000 – $0) × $100,000 ÷ $100,000	(100,000)
PUC of preferred shares after reduction	$ —

Deemed dividend [84.1(1)(b)]

(A + D) – (E + F) ($100,000 + $500,000) – ($500,000 + $100,000)	$ —

For Sonia Holding Inc.:

ACB of the 4,000 shares of Patrimonius Inc. [85(1)(a)]	$ 500,000
PUC of the 4,000 shares of Patrimonius Inc.	$ 40,000

3. Purchase of the 4,000 shares by Patrimonius Inc. — 2008

Deemed dividend [84(3)]

Amount paid	$ 600,000
PUC of the 4,000 shares	(40,000)
Deemed dividend	$ 560,000

This dividend between Canadian corporations is not subject to Part I tax, nor will it be subject to the Part IV refundable tax, unless Patrimonius Inc. is entitled to a DTR, since these are connected corporations.

Subsection 55(2) does not apply in this case because of the exception contained in paragraph 55(3)(a), since Sonia Holding and Patrimonius Inc. are related persons [251(2)(c)(ii)].

Capital gain

POD [54]		
Amount paid	$ 600,000	
Deemed dividend [84(3)]	(560,000)	$ 40,000
ACB [85(1)(b)]		(500,000)
Capital loss		(460,000)
Reduction [112(3)]		(460,000)
		$ —

4. Discharge of the note to Sonia

There is no tax consequence, since the ACB of the note is equal to its face value.

In Example 8-17, if the shares of Patrimonius Inc. had been eligible for the CGD and that deduction had been claimed, the solution would have been different. There would have been no taxable amount in the year of death. On the other hand, under paragraph 84.1(1)(b), there would have been a` taxable dividend of $460,000 on the transfer of the shares to Sonia Holding Inc. The ACB of the 4,000 shares for the purposes of subsection 84.1(1) would have been $40,000 ($500,000 – $460,000) instead of $500,000, since under subparagraph 84.1(2)(a.1)(ii), the ACB must be reduced by an amount equal to the capital gain on which the CGD was claimed.

READING 8-9

Planning

LEVEL 1

Will planning

As you have seen, the significance of the tax consequences on death depends on the type of property bequeathed and the persons to whom it is bequeathed. In addition, many elections are required to minimize income taxes. The will is the most important document in estate planning because it is through this document that the wishes of the deceased regarding the transmission of his property and the powers given to his executors are made known.

Here are some estate planning points currently in use:

- bequest of RRSP to the spouse or common-law partner, who may then transfer them to his own RRSP
- bequest of property, the deemed disposition of which on death otherwise results in substantial taxable gains, to the spouse or common-law partner, or to a spousal or common-law partner trust, to defer the tax until the spouse's or common-law partner's death
- bequest of income-earning property to minor children, or to a trust for the benefit of minor children, for the purpose of splitting income between the spouse or common-law partner and the minor children
- allowing executors to make all the tax elections that they may deem necessary in the circumstances

Post-mortem planning points

Post-mortem planning is planning that can be undertaken using the tax elections allowed by the ITA

- on the deceased's income tax and benefit return

or

- by the estate

in order to minimize tax.

This section covers some post-mortem planning points. Each situation must be evaluated independently, taking into account the particular facts and circumstances. Above all, it is necessary to make sure that choices made for tax reasons are permitted by the will and do not have the effect of benefiting some beneficiaries to the detriment of others, in which case there could be legal problems.

Deceased person

- Use the CGD on qualified farm properties and qualified small business corporation shares by making the election under subsection 70(6.2) on property bequeathed to the spouse or common-law partner or to a spousal or common-law partner trust, where required.
- File separate returns for the following:
  - rights or things
  - business income
  - income from a trust

- Where there is no specified beneficiary for the RRSP, make the election under subsection 146(8.1) to attribute the RRSP to the spouse or common-law partner. The spouse or common-law partner rather than the deceased will be taxed on the amount received from the RRSP. Note that the spouse or common-law partner may roll over the RRSP received from the deceased to his own RRSP, thereby deferring any tax consequences.

Estate and beneficiaries

- Make the election under subsection 164(6) where the estate disposes of property at a loss in the year following death.
- When the deceased person held shares of a private corporation, determine the best strategy for avoiding or minimizing potential double taxation, such as winding up the corporation in the year following death or transferring the shares to another corporation.
- Select the fiscal year of the estate and testamentary trusts to defer the maximum amount of tax.