Canada

International Estate Planning Guide

Individual Tax and Private Client Committee

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A. *Overview*

Anyone with mental capacity who is over the age of majority may make a valid will in Canada. The age of majority varies by province, being either 18 or 19. A will enables a person to dispose of his or her estate according to his or her wishes, and to appoint and empower his or her executors (estate trustees) as the person sees fit, subject to certain limitations. In the absence of a will, a person's estate will be administered and distributed under the applicable provincial rules governing intestacy.

Testamentary freedom under a will is constrained by legal obligations to satisfy creditors, tax obligations, and to provide support to a surviving spouse and surviving dependents. If these amounts are not provided for, the will may be open to challenge in court. There is no forced heirship per se in Canada, although the practical result of the mandatory support obligations for spouses and dependents is comparable and makes disinheriting a spouse or child difficult or impossible, depending on the circumstances. Testamentary freedom is also constrained insofar as wishes that offend public policy may not be enforceable. For example, making a gift conditional on leaving one's spouse, not having children, or racially or religiously motivated conditions may be deemed contrary to public policy and not enforced.

There is no obligation to provide for an adult, non-dependent child in one's will. However, this has been the subject of change in the courts with the relatively recent advent of the 'moral obligation', which may be found to exist in the context of family members who feel unfairly excluded from an inheritance, even though they are not dependents.[1]

A Canadian will is a flexible document that allows for broad testamentary discretion in terms of how the estate is distributed and to whom. Recipients under a will may include not only family, but also friends, business partners, charities and so on. Assets may be distributed as soon as the administration allows or may be held in trust for a longer duration on any terms set out in the will (subject to limitations based on public policy).

B. *Formalities*

The formalities required for the preparation, signing and witnessing of a will vary slightly from province to province, but, generally speaking, the requirement is for the testator to sign the will before two witnesses, neither of whom are beneficiaries nor spouses of beneficiaries under the will. Remote witnessing using video conference tools is now permitted in most provinces as well. A will does not need to be notarised, just witnessed. Other than in the province of Quebec, there is no formal will registry in Canada, and it is the responsibility of the testator to ensure that his or her will is discoverable upon death. There are, however, private or non-profit initiatives that maintain unofficial will registries that can assist with determining whether a will exists in respect of a deceased individual. Registration is entirely voluntary, so cannot be relied upon as definitive. If no will can be found upon death, any will may be deemed revoked and the rules of intestacy will apply.

Alternatively, a holographic will made entirely in the handwriting of the testator and signed by the testator is permissible.

The witnessing formalities and age requirements are relaxed in some circumstances for active service members in the Canadian armed forces and for sailors during a voyage.

Oral wills are not effective in Canada.

There are additional formalities for wills that are intended to qualify as 'international wills' pursuant to the Convention Providing a Uniform Law on the Form of an International Will, to which Canada is a signatory. International wills are discussed further below.

We note that the discussion below on 'pour-over trusts' is relevant to testamentary freedom in a will and will formalities (section IV.D.9).

C. *Probate*

Whenever a will in Canada deals with assets that are subject to probate, the will must be submitted to the courts of the relevant province, with an application to have the will probated. Assets that require probate typically include real estate, other registered assets and accounts with financial institutions. The grant of probate allows third parties, such as the land title registry, banks and investment managers, to rely on the authority of the executor without fear of liability if the executor's authority is later challenged. Probate is not required for many other types of assets, including personal effects, vehicles and, notably, shares in private companies.

Probate fees (or probate taxes) are payable on the entire estate, not only the probatable assets. The amount of probate fees/taxes varies from province to province, ranging from just under 1.7 per cent in Nova Scotia at the highest end to low flat fees in some other provinces at the lower end.

In Ontario and British Columbia, it is possible to have two separate wills, where one deals only with assets subject to probate and the other deals with assets that do not require probate. On death, only the probatable will is submitted to probate and fees/taxes are calculated only on the basis of the assets dealt with under that will. Probate fees are therefore avoided on the value of all assets under the secondary (non-probate) will. This is a common planning technique in Ontario and British Columbia. Such dual will planning is not permissible in other provinces as of the date of writing.

In the case of foreign assets dealt with under a Canadian will, the Canadian grant of probate is not likely to be recognised in the foreign jurisdiction. An application to the foreign courts to either recognise the Canadian grant of probate or a fresh application to recognise the Canadian will would be required. Advice should, of course, be obtained during the planning phase to ensure that the Canadian will will be recognised in the foreign jurisdiction, or a separate foreign will should be executed in line with local requirements in respect of foreign property.

D. *Conflict of laws, foreign wills and foreign assets*

The law governing the succession of moveable property is generally the law of the domicile of the testator at the time of death and, for immovable property, the law of the place where the property is located. A foreign will is eligible to be submitted to probate in a Canadian court if the will was properly made under the laws of the place where it was made, or of the place of the testator's domicile or habitual residence. Matters relating to the will's essential validity will then be considered under the laws of the place of the testator's domicile at death or the place where the relevant property is located (the *lex situs*), as the case may be. 'Essential validity' includes questions of the validity of gifts made in the will, forced heirship, capacity to make the will and questions about undue influence. The ability of a spouse or dependent to make a claim is also governed by the law of the domicile of the testator at death (or for immovable property, the *lex situs*).

A Canadian will's effectiveness in dealing with foreign assets must be considered on a jurisdiction-by-jurisdiction basis, depending on where the foreign assets are located and the nature of the asset (moveable or immovable and subject to probate or not). It should not be assumed that a Canadian will will be effective in any foreign jurisdiction, and testators are usually advised to make separate wills for each jurisdiction in which they have assets, especially immovable assets.

Where probate has been granted in a foreign jurisdiction and is sought to be relied upon in Canada for the administration of assets in Canada, an application may be brought to the courts of the relevant Canadian province to re-seal the original grant of probate (for commonwealth countries) or apply afresh for an ancillary grant of probate (for non-commonwealth countries).

E. *International wills*

Canada is a signatory to the Convention Providing a Uniform Law on the Form of an International Will, which provides for the mutual recognition and validity of wills among signatory jurisdictions, provided the will complies with certain formalities with respect to its execution and witnessing (including a certification by an authorised person, such as a lawyer, that the formalities were complied with). The will is then required to be accepted in all signatory countries without further attestation or authentication.

Notwithstanding the ostensible usefulness of such wills, they are rarely used in Canada.

F. *Domicile and residence*

For Canadian law purposes, one's domicile and place of residence are often the same, but they may not always be the same. The place of residence is the place where the person has his or her home at any given time. The concept of domicile is more permanent. Domicile may be the place where the person has his or her residence or the place where the person has the centre of his or her affairs (centre of vital interests), the seat of his or her wealth and/or the seat of his or her family, and potentially other indications of the place representing a permanent home. A person is born with a domicile of origin (which is not always the place of birth; it may issue from the parents' domicile) and this can change throughout a person's life through the choices they make with respect to where they have their home and work, build their life, have their family and so on. For many, determining the place of domicile is not difficult. For people who habitually move from jurisdiction to jurisdiction or have roots in multiple countries, it can be more challenging and may require a detailed review.

Note that the concept of tax residency is discussed separately below in this guide.

G. *Powers of attorney*

Canadians are typically advised to have two powers of attorney in place as part of their estate plan: a continuing power of attorney for property and a power of attorney for personal care. The former grants the attorney(s) power to deal with the grantor's finances and assets, and is usually intended to come into effect upon the grantor's incapacity. Incapacity can be defined in the power of attorney itself and typically refers to one or more independent assessments by a physician or capacity assessor. The latter grants the attorney(s) power to make healthcare decisions on the grantor's behalf once the grantor loses the capacity to do so, and in this context, capacity is defined by statute.

Powers of attorney need to be executed by the grantor while the grantor still has capacity and must be signed before two independent witnesses. They do not need to be signed before a notary or otherwise attested, with the exception of powers of attorney ('mandates') in Quebec, which must be 'homologated' by a prothonotary to be effective.

II. Will alternatives

Certain mechanisms are available for the transfer of property on or before death, which are used as alternatives or partial alternatives to a will.

A. *Joint ownership*

In all the provinces of Canada, property can be jointly owned by two or more persons, and in all provinces except Quebec, that joint ownership can include a right of survivorship. Property that is jointly owned with a right of survivorship will pass automatically, by operation of law, to the surviving joint owner(s) upon the death of one joint owner, without the need for a will. Holding assets jointly for this purpose is popular between spouses with respect to the marital home and other real estate, and with respect to bank accounts. Other family members (children) are also often included as joint owners. Note that, ever since the 2007 Supreme Court of Canada case *Pecore v Pecore,*[2] it has become necessary to clearly indicate one's intention with respect to whether or not the joint ownership in question is intended to have a right of survivorship. Failing such a clear expression of intention, there may be a 'presumption of resulting trust' (rather than a presumption of advancement) for joint ownership arrangements, whereby only bare legal ownership will pass to the surviving joint owner(s), but they will be presumed to be holding the deceased's beneficial interest in the property in trust for the deceased's estate. It has become common practice to expressly state in one's will that assets held jointly are indeed intended to pass legally *and beneficially* to the surviving joint owner(s). Assets that pass in this manner are not subject to the probate process or probate fees.

B. *Beneficiary designations*

It is possible to designate a beneficiary of certain registered retirement savings plans in Canada, and where that is the case, the proceeds of the plan will pass to the designated beneficiaries outside of the person's will. The proceeds of insurance policies may, of course, also be paid to designated beneficiaries.

C. *Inter vivos trusts*

Transferring assets to trusts made during one's lifetime, or *inter vivos* trusts, is a popular succession planning technique in Canada. Once the asset is transferred to a validly created trust, the trust simply carries on administering or distributing the assets according to the terms of the trust, unaffected by the death of the settler (although there may be a taxable event on the settler's death, in some cases). A transfer of assets to a trust during life is typically a taxable disposition in Canada, triggering the realisation of any accrued capital gains on the assets transferred. However, transfers to some types of *inter vivos* trusts are exempt from such treatment, allowing for a transfer on a tax-deferred basis (known as a 'rollover'). Such trusts are known generally as life interest trusts, and include what are known as alter ego trusts and joint partner/spousal trusts. These types of trust must be created within strict guidelines as to who may benefit from the trust income and capital during the lifetime of the settler. For instance, for an alter ego trust, only the settler is permitted to benefit during his or her lifetime. For a joint partner trust, only the settler and his or her spouse or common law partner are permitted to benefit during the settler's lifetime. Such trusts can be created only after the settler reaches 65 years of age. There is a taxable event (deemed disposition) for the trust on the settler's death, and then after the settler's death other beneficiaries are permitted to receive income and/or capital benefits from the trust without limitation (thereby bypassing the need for a will for the assets held in trust).

Inter vivos trusts are often used to achieve income splitting among family members during the settler's life (which can offer tax efficiencies), as well as to facilitate succession planning and to enable the co-ownership and management of property among multiple beneficiaries. It is important to take into account the tax consequences of planning using trusts because Canada taxes trust income aggressively, and there are many complex attribution rules that operate to attribute trust income and gains back to the settler personally for tax purposes. The use of *inter vivos* trusts in Canada, and the manner in which they are designed, is predominantly driven by tax considerations.

D. *Gifts during one's lifetime*

There is no restriction on one's ability to give gifts during one's lifetime, whether as an advance on an inheritance or otherwise, provided the person has mental capacity. There is no 'gift tax' as such, but there may still be tax consequences to the making of a gift, such as a deemed disposition at fair market value for the giftor (with tax payable on the deemed gain). There is no tax payable by the recipient of a personal gift in Canada.

III. Intestacy

If a Canadian resident dies intestate, the estate is distributed according to rules that vary from province to province, although the scheme of distribution is fairly similar across all provinces. A surviving spouse is always given priority, either for the full estate outright if there are no children of the deceased (except in Quebec), or, if the deceased has children, a preferential share will go to the spouse and the remainder to the children. If there are no children and no spouse, provincial law provides for successively more distant relatives as the heirs, generally following this pattern: first children, then grandchildren, then parents, then siblings, then further next of kin, if any. If there is no next of kin at all, the estate of the deceased will devolve to the state.

For intestate estates, a person must apply to the court to be appointed as executor, and generally priority is given to relatives in the same order as for rights of distribution on intestacy as summarised above, starting with the surviving spouse, then adult children and so on. If there is no one willing or able to act as executor, the office of the public guardian and trustee in each province would be appointed as a last resort.

IV. Trusts

The principles of trust law applicable in Canada were adopted from the English common law tradition, so will be largely familiar to most common law practitioners. Canadian legislation and case law have since modified the English law position on some issues, but the fundamental principles of trusts, and the rights and obligations of the various parties to a trust remain unchanged. Trusts are a common and important feature of the Canadian estate planning landscape.

A. *Formation of a trust*

A written trust instrument is not strictly required for a valid trust in Canada, although it is recommended for the sake of clarity and evidence, and virtually all trusts that are deliberately established in Canada are formed pursuant to a written trust instrument. For a valid trust to exist, the so-called ‘three certainties’ must be present: (1) certainty of intention (being the settler’s intention to establish a trust, hence the usefulness of a written trust deed); (2) certainty of subject matter (what property is being put into the trust); and (3) certainty of objects (the purpose of, or beneficiaries of, the trust). If any of the three certainties is missing, there is no valid trust under Canadian law. Further, the trust must also be validly constituted, which requires the transfer of legal ownership of the trust property into the name(s) of the trustee(s).

A trust comes into existence once all the above elements are present. There is no trust registry in Canada (other than for wills in Quebec). Note that a trust is a tax paying entity in Canada and every trust resident in Canada must register with the Canada Revenue Agency (CRA), have a taxpayer number and file tax returns (a responsibility of the trustees). While there is no registration of a trust instrument (or a will) that is required for the trust (or will) to be valid, a copy of the trust instrument (or will) typically needs to be filed with the CRA for the trust’s first reporting year (or the first reporting year of the estate for wills).

Trusts can also come into being by an operation of law under certain equitable principles, such as *quantum meruit*. These are known as constructive trusts, or resulting trusts, where a person enjoying ownership or control of property is deemed to be holding it for the benefit of another person in order to achieve an equitable result at law.

Note that the rule in *Saunders v Vautier* applies in Canada; that is, if all beneficiaries of a trust are of age and have capacity, they may by unanimous consent demand the collapse of the trust and distribution of the trust property immediately. It is important to avoid the application of this rule, usually by providing for contingent ‘gift over’ beneficiaries who have a future interest in the trust property or by defining the class of beneficiaries broadly enough in a discretionary trust that it becomes impossible for all beneficiaries to act unanimously.

Note also that onerous new disclosure requirements with respect to trustees, settlers and beneficiaries (and protectors if applicable) are set to come into effect in Canada for taxation years ending on or after 31 December 2023. The new rules will require significantly heightened disclosure to the CRA in respect of each such party and will significantly expand the circumstances in which any trust resident in Canada is required to file a T3 return (a trust's primary income tax reporting return). The new requirements will also impose a greater burden on trustees, who will be obligated to obtain and maintain all information, which they may not otherwise have had (eg, seeking out each beneficiary of each class and obtaining the required data from them, even if no entitlements have arisen and even if such beneficiaries may be unaware that they are beneficiaries). Such disclosure requirements will impose a significant new burden on trusts and trustees and may deter the establishment of trusts, to some extent.

B. *Parties to a trust*

The basic parties in the trust relationship are the settler, trustee and beneficiaries, and this is the same in Canada. There is no statutory recognition of a protector or any similar role in Canada, but there is nothing that prevents the use of a protector in a Canadian trust if so desired and drafted into the trust instrument. Care must be taken to ensure that a protector is not given such broad powers as to be effectively deemed to be a trustee, as could be the case if it is found that the protector is the party that exercises genuine control over trust decisions, having regard to the actual decision-making processes and communications among the trust parties.

The basic duty of a trustee is to act in the best interest of the beneficiaries, subject to the intentions of the settler, as expressed in the trust deed or otherwise known to the trustee. Specific duties of the trustee in Canada include a duty of care, duty not to delegate, duty to act impartially, duty of loyalty, and duty to provide information and account to beneficiaries. There is substantial jurisprudence elaborating on the nature of each of these duties, a detailed discussion of which is beyond the scope of this summary. It is important to bear in mind that the duties of the trustee can be modified, or overridden entirely, by the terms of the trust deed, so the starting point for a meaningful review of trustee duties with respect to any specific trust must be the trust deed.

C. *Deemed dispositions, accumulations and rule against perpetuities*

There is deemed disposition of all assets held by the trust every 21 years, triggering potential capital gains and, therefore, a tax liability on such gains. This can be problematic because a deemed disposition is a fiction and does not result in any actual liquidity for the trust, so the trust may be unable to pay the tax without selling off some of its assets. As a result, many trusts in Canada are designed to terminate in 21 years less a day.

The above 21-year period also often aligns with the rule against extended accumulations of income on trust property, which is a restriction included in the laws of several Canadian provinces. Beyond the permitted accumulations period, the trust may continue to exist, but must distribute the income it receives each year and no longer accumulate it. Charitable purpose trusts are exempted from this restriction.

Canada also observes the much-criticised and certainly antiquated 'rule against perpetuities', which limits the life of a trust to the lifetime of the last to die of a relevant 'life in being' plus 21 years (a 'life in being' being someone relevant to the trust, such as a beneficiary). The rule is modified, to some extent, from province to province.

The above rules make it effectively impossible to maintain a legacy trust in Canada.

D. *Common uses in Canada*

The purposes for which trusts are used in Canada is enormously varied and has long been the subject of much creativity, and this continues currently. However, for illustrative purposes, some common uses are summarised here.

1. CONFIDENTIALITY

As a general matter, trusts are sometimes used instead of wills because wills become public record once they are probated, whereas dispositions to trusts and the terms of trust deeds are non-public (unless they are made the subject of litigation subsequently). The use of so-called 'secret' and 'semi-secret' trusts[3] is also possible in Canada, where confidentiality is desired.

2. Asset protection

Another general benefit of trusts is asset protection. Claims against a settler's assets do not include assets transferred into a trust because the settler does not legally (or beneficially) own such assets. There are numerous exceptions to this rule and the asset protection achieved can be challenged under Canada's fraudulent conveyance legislation if the purpose of the transfer to the trust was to hinder or delay creditors. Such transfers may also not be effective against trustees in bankruptcy, or against the lawful claims of spouses or dependents. However, for claims that only arise after the transfer, some degree of asset protection is indeed provided by a trust. Such trusts typically include certain creditor-protection provisions as well, which tend to provide that a beneficiary's interest in the trust becomes suspended for so long as there is a risk of seizure by a creditor. Where there are sufficient assets to justify the cost of establishing a trust in an offshore jurisdiction, it is possible to achieve stronger creditor-protection using such structures.

3. Discretionary family trusts

These are used for succession planning, and often for income splitting to gain tax efficiencies. Such trusts are also commonly set up as so-called 'prescribed rate loan trusts', whereby a party (ie, a would-be settler) can lend funds to the trust at a rate of interest prescribed by the CRA and such an amount will not be deemed to be a gift to the trust, but rather an arm's-length loan, which allows the trust to invest the funds on its own account and distribute the income or gains received to other beneficiaries without attributing such income/gains back to the lender. It is a popular income-splitting technique.

4. Trusts for persons with disabilities

In place of an outright inheritance, it is often preferable to establish a trust for the benefit of disabled beneficiaries who are not capable of managing their own financial affairs. Such trusts are often fully discretionary to avoid any minimum entitlement of the beneficiary, so the beneficiary can retain access to government benefit programmes (such discretionary trusts for disabled beneficiaries are known as Henson Trusts in Canada). Some such benefits are subject to income thresholds (ie, you are disqualified from such benefits if you have too much other income).

5. Spendthrift trusts

Similar to a trust for disabled persons, spendthrift trusts are established for beneficiaries (often an adult child) who struggle with managing money and to whom a settler does not wish to gift a lump sum amount for fear the beneficiary will spend it unwisely.

6. Life interest trusts

As also noted above, these are trusts that enjoy certain income tax incentives and are intended to allow a settler to establish a trust that, during the settler's life, benefits only themselves and/or their spouse or common law partner, but anyone on death. The income tax incentive is essentially the fact that transfers can be made to such trusts on a 'rollover' (tax-deferred) basis, so there is no negative tax consequence to establishing them. They are effectively will alternatives and allow a settler to avoid probate fees and the estate administration process with respect to the assets placed in trust.

7. Insurance trusts

These are trusts designed to receive and manage the proceeds of life insurance. They are drafted and executed during life, but do not come into existence until the proceeds are paid to the trustee. The proceeds of insurance may also be payable to a pre-existing trust, if desired (eg, a family trust that was created during life). The beneficiary designation for the life insurance in question should also name the trust expressly or the trustee 'in trust' pursuant to the trust deed as expressly identified. This allows for the proceeds to be paid outside the deceased's estate, bypassing probate and maintaining confidentiality.

8. Testamentary trusts

Typically, these are trusts created under the terms of the will itself. A common type of testamentary trust is a trust for young beneficiaries, so their inheritance can be held until they reach the age of majority or another specified age. Another common type of testamentary trust is a spousal trust, in which the first-to-die spouse leaves an inheritance to the surviving spouse by way of a trust in which the spouse has access only to the income generated by the inheritance, and either some, all or none of the capital amount. Upon the death of the surviving spouse, the remainder is then distributed to the children or others as the first-to-die spouse specified in his or her will. The spousal trust protects the inheritance for remainder beneficiaries (children), while still providing ongoing support for the surviving spouse during life, but without giving the surviving spouse control over the bulk of the inheritance.

9. Pour-over trusts

It was a popular practice for Canadians with United States beneficiaries to include in their wills a 'pour-over' clause, whereby gifts intended for a US beneficiary would be made to an existing US trust instead of to the individual(s) directly. The will is said to 'pour over' into the existing US trust. Such pour-over clauses are likely to be no longer enforceable in Canada following recent court decisions in British Columbia and Ontario.[4] The court found that such clauses effectively allowed for the terms of the will to be changed (because of the possibility of amendments to the US trust terms) without complying with the formalities of a valid will amendment applicable in British Columbia or Ontario. While the inclusion of a 'pour-over' clause is prohibited, careful planning is required to ensure that it will be enforceable, and any Canadian will containing such a clause should include a fall-back position to avoid intestacy or partial intestacy.

E. *Taxation of trusts*

This section will provide a very high-level description of how trusts are taxed in Canada. There are many exceptions and further details to the general information that follows here. Professional advice should always be sought when tax planning with trusts.

A trust is a taxpayer in Canada and taxed as an individual on all its income and capital gains realised in any year. If the trust pays out (or makes payable) its income or gains in any year to beneficiaries during the year, the trust's own income/gains are reduced accordingly. Therefore, if a trust pays out all of its income and gains in any year and does not retain any, it will not owe any tax; that is, a trust is not taxed on income and gains that flow through it, only on income and gains that it retains. If a trust retains taxable income or gains, the trust is taxed as an individual, but at the highest marginal tax rate applicable in the trust's province of residence (just over or under 50 per cent, depending on the province). The amounts that a trust pays out to beneficiaries are taxable to the beneficiaries as income, capital gains, dividends or otherwise at each beneficiary's own marginal tax rates. Therefore, when a trust distributes income among several beneficiaries, it can potentially take advantage of the lower marginal tax rates of the beneficiaries to achieve an overall reduction in tax (ie, income splitting).

Rules operate to attribute the income of the trust to a contributor to the trust for income tax purposes in certain circumstances, which prevent income splitting in many circumstances. These are known as the 'attribution rules' and tend to apply when trusts are established for family members, on non-arm's-length terms or if the settler retains too much control over trust property. It is important to be cognisant of the attribution rules when planning with trusts. If there is a family business involved or a private corporation in which family members have an interest, there is also another set of rules known as the 'tax on split income' rules (TOSI), which apply to prevent income splitting from the business, whether through a trust or directly from the corporation, subject to a small number of exceptions.

V. Treatment of foreign trusts and foundations

A. *Foreign trusts*

Canada recognises foreign trusts. The key question with respect to Canada's treatment of foreign trusts is determining which foreign trusts will be considered resident in Canada for tax purposes. A foreign trust can be either deemed resident in Canada or can be found to be factually resident in Canada, despite its establishment under the laws of another jurisdiction. In simplified terms, a foreign trust will be deemed tax-resident in Canada if:

- any Canadian resident ever contributed assets to it, in any manner whatsoever, directly or indirectly (there are extensive anti-avoidance rules defining what a constitutes a 'contribution' and it is extremely inclusive); or
- a non-resident of Canada contributed assets to it while non-resident, but was a Canadian resident within the past five-year period or subsequently became a Canadian resident in the following five-year period, *and* there is any Canadian beneficiary of the trust.[5]

A foreign trust will be considered to be factually resident in Canada as a result of common law tests of residency if its centre of mind and management is physically located in Canada. This can occur if trustees reside in, or exercise authority while present in, Canada. It can also occur if a court finds that the foreign trustees were mere nominees and actual control is exercised by a person in Canada, such as a protector, or, potentially, a group of beneficiaries acting together, for example. The place of the exercise of actual control is what will govern.

If a foreign trust is found to be deemed or factually resident in Canada for tax purposes, the trust will be taxed in Canada on its worldwide income, required to file tax returns and subject to Canada's deemed disposition of all assets every 21 years, among other things. A foreign trust that is deemed resident in Canada is not resident in any one province, so the provincial tax component that would normally apply as part of the tax rate applicable to the trust is replaced by starting with the federal income tax rate and adding an additional 48 per cent to that figure to compensate for the missing provincial tax (this actually results in a slight saving in comparison to the higher tax provinces). Beneficiaries that receive distributions from foreign trusts must also file specific forms with the CRA to declare such receipts.

Canada's treatment of foreign trusts is designed to ensure that a Canadian resident otherwise subject to Canadian tax cannot obtain any meaningful tax benefit simply by establishing a trust in a low-tax jurisdiction, or contributing to one, in any manner directly or indirectly. As noted, Canada has developed extensive anti-avoidance rules intended to forestall abusive structuring.

If a Canadian resident is a beneficiary of a foreign trust, where the foreign trust is not deemed resident or factually resident in Canada, then the foreign trust will not be subject to Canadian taxation; the Canadian resident beneficiary may receive distributions of trust capital on a tax-free basis; and distributions of income will be subject to income tax.

As of the date of writing, there is still scope for effective planning using foreign trusts to benefit Canadian beneficiaries when the settler is, or will soon become, a non-resident of Canada. As noted above, foreign trusts can also be effective asset protection vehicles in the appropriate circumstances.

B. *Foreign private foundations*

Canada's treatment of foreign private foundations is not as clear cut as its treatment of foreign trusts. Private foundations do not exist under the laws of Canada, and there is not a large amount of Canadian jurisprudence dealing with foreign private foundations, so authoritative guidance is relatively limited. The approach taken by the CRA and courts so far has been to review the characteristics of the private foundation and categorise it as either a trust or corporation, depending on which it more closely resembles.[6] Questions such as whether the 'three certainties' are present; whether there is a role analogous to a trustee that has a fiduciary obligation to persons who are or are comparable to beneficiaries; and whether any beneficiaries have the right to enforce the terms of the foundation will be important to the analysis because the most important consideration is the nature of the relationships among the parties, and their respective rights and obligations. If there are not sufficient elements of a common law trust present, a Canadian court is likely to treat the private foundation as a corporation rather than a trust, and tax the foundation and its beneficiaries accordingly. This is an area in which there continues to be some uncertainty, which makes planning using foreign foundations potentially risky for Canadians. Each foundation and each set of personal circumstances must be considered case by case.

VI. Taxation

A. *Overview: tax on death*

Like most countries, Canada taxes on the basis of residency. If a person is Canadian resident for tax purposes, he or she is subject to tax in Canada on his or her worldwide income from all sources (employment, business, dividends, rent, royalties, interest, director's fees, income distributions from trusts etc). As of the date of writing, Canada applies income tax and capital gains tax, but does not currently apply gift tax, inheritance tax or wealth tax. Probate fees or probate taxes are applied, and they differ from province to province (with 1.695 per cent of the estate value representing the high end of the spectrum).

Generally, capital gains are not taxed until the gain is realised by way of a sale or disposition of the asset, so merely holding an asset that accrues in value year after year will not trigger any taxable capital gains. A Canadian resident is deemed to have disposed of all of his or her assets at fair market value in the moment immediately prior to death, thereby realising any accrued capital gains. This deemed disposition is often the primary source of taxation on death for a Canadian. There are many forms of relief for the taxation incurred on death, such as the ability to reduce the deemed capital gains with any capital losses accrued during life or, in some cases, accrued after death, where the loss can be carried and used to offset the gain incurred on death, and a lifetime capital gains exemption allowance on certain types of capital property. A detailed review of tax credits or reductions available on death is well beyond the scope of this summary, and each person's situation can vary greatly based on his or her personal circumstances, assets, family composition, life and business history, charitable donations and steps taken by the estate after death to carry out post-mortem tax planning.

An important exception to the deemed disposition on death is the transfer of assets to a surviving spouse or common law partner (or spousal/partner trust). Such transfers are permitted to occur on a tax-deferred basis, so there is effectively no tax on assets that are left to a surviving spouse or common law partner. Tax will be incurred on the death of the second spouse.

Life insurance proceeds are not taxed, so insurance planning is an important part of Canadian estate planning.

A summary of the taxation of trusts is included above in section IV.E.

B. *Tax residency*

Tax residency in Canada is determined by reference to a person's residential ties to Canada, which indicate an intention to treat Canada as one's permanent home. There are 'primary' and 'secondary' residential ties. Primary residential ties refer to maintaining a place of dwelling in Canada that remains available to the person throughout the year[7] and having a spouse or dependents who live in Canada. If a person has any such primary residential ties, it is likely that he or she will be considered a Canadian resident by the CRA, even if he or she does not actually spend significant time in Canada. Secondary residential ties include any other ties to Canada that indicate an intention to reside permanently in Canada. These can include a great many aspects of everyday life, including seemingly minor connections to Canada. They may include the maintenance of a Canadian driver's licence, health card, bank accounts, credit cards, keeping furniture in storage in Canada, owning a vehicle in Canada, frequency of visits and a seasonal home. Retaining one or even several secondary residential ties may not necessarily result in a finding of residency, depending on the view of the person's life situation overall and whether it suggests an intention to treat Canada as his or her home.

Notwithstanding a determination of residency made on the basis of residential ties as described above, one's residency may be determined instead by the rules under a relevant tax treaty. If a person is considered to be resident in both Canada and another country with which Canada has a tax treaty, reference should be made to the treaty to confirm whether it contains tie-breaker rules that may dictate the outcome of the residency analysis.

C. *Treaties*

Canada has entered into many bilateral tax treaties that reduce or eliminate double taxation in some circumstances.[8] They may also contain rules regarding residency in each country, including tie-breaker rules as noted above.

It is worth noting that a Canadian resident who dies owning foreign property will be deemed to have disposed of that foreign property at the time of death; will therefore realise taxable capital gains in Canada on such property; and may also be taxed in the country in which the property is located by way of capital gains tax or inheritance tax. If the foreign tax is capital gains tax, the foreign tax payable is likely to result in a foreign tax credit, which can be used to reduce the Canadian tax liability. However, if the foreign tax is inheritance tax, it is not likely to result in a foreign tax credit that can be used to reduce the Canadian capital gains tax, resulting in double taxation. Planning should be undertaken during life to minimise the impact of such double taxation.

D. *Tax planning on death*

Achieving the reduction, elimination and deferral of taxation on death is the subject of a great deal of time and effort spent by the estate planning industry in Canada, and there are a large number of strategies available to achieve tax benefits on death. Such strategies are invariably subject to the specific circumstances of each person and the nature of the assets that make up his or her estate, particularly if the person is a business owner.

The use of wills, trusts, corporations, joint ownership, insurance products, gifts during life and the use of elections, credits, exemptions, offsets and rollovers on death are all common tools to achieve estate planning and tax planning goals.

Notes

[*] **Notice to reader:** This guide sets out a high-level summary of a select number of areas relating to estate planning in Canada and is intended as general information only. It is not comprehensive and must not be relied on as advice. The law as it pertains to estate planning in Canada is very developed, very detailed and continues to evolve rapidly, and professional advice is strongly recommended for any Canadian estate planning queries.

[1] *Tataryn v Tataryn Estate* [1994] 2 SCR 807 is the Supreme Court of Canada decision that established the existence of the moral obligation towards adult children, irrespective of need or dependency. That decision related to legislation and facts in British Columbia. The existence of a moral obligation in other provinces remains somewhat uncertain and it is a developing area of the law in Canada.

[2] *Pecore v Pecore* [2007] SCJ No 17, 279 DLR (4th) 513, 32 ETR (3d) 1 (SCC).

[3] A 'secret' trust is where a gift is made under a will to beneficiary X, and X has been instructed outside the will to hold the gift in trust for the benefit of Y (so the existence and terms of the trust are secret). A 'semi-secret' trust is where a gift is made under a will to beneficiary X subject to X holding the gift in trust for Y, but the terms of the trust are communicated to X outside the will (so the

existence of the trust is not secret, but its terms are secret). There is no statutory recognition of such trusts, but the courts in Canada have been willing to enforce them subject to certain formalities being observed.

[4] *Quinn Estate v Rydland* (2019 BCCA 91) and *Vilenski v Weinrib-Wolfman* decision (2022 ONSC 2116).

[5] Note that 'successor beneficiaries' who are residents of Canada are excluded, being beneficiaries whose interest in the trust only arises on the death of the settlor. In addition, the five-year period is reduced to 18 months for testamentary trusts that are created under the deceased's will (ie, if the deceased was non-resident of Canada for at least 18 months by the time of death, instead of the usual five years during life).

[6] As summarised in the 2012 Federal Court of Appeal judgment in *The Queen v Peter Sommerer* (2012 FCA 207), and consistent with the earlier Supreme Court of Canada judgment in *Backman v Canada* [2001] 1 SCR 367, 2001 SCC 10 and various CRA positions (see *Income Tax Technical News* no 38, 22 September 2008, eg, and, more recently, Income Tax Folio S4-F16-C1).

[7] Note, owning real property in Canada is not necessarily problematic if it has been leased out on commercial terms to a third party so that it is not available for the owner's own use.

[8] An up-to-date list of Canada's tax treaties can be found at www.canada.ca/en/department-finance/programs/tax-policy/tax-treaties.html accessed 14 September 2023.