

Estate Planner

Change of Trustees = Tax Disaster?

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Just a few days ago, the CRA released a Technical Interpretation[1] that could have widespread repercussions to practitioners involved in administration of trusts and estates. The "Technical" canvasses whether control of a corporation is acquired when a trustee of a trust that controls a corporation is replaced. The Technical's short answer: with the *possible* exception of situations where the replacement trustee is related to the pre-existing trustees, yes.

The Technical itself deals with *inter vivos* trusts. While it may be somewhat unusual for such a trust to control a corporation, it would seem that the same result would occur where there is a replacement of executors of an estate, in which a control situation is much more likely.

Because of the importance of the Technical, we have reproduced it below in its entirety; Situation 1 highlights the difficulty. Essentially, the CRA's position (which is based on *M.N.R. v. Consolidated Holding Company Limited*, 72 DTC 6007 (SCC)) is that, in the absence of evidence to the contrary, the CRA considers there to be a presumption that all of the trustees of a trust constitute a group that controls the corporation. It would follow from this that the replacement of a trustee would constitute an acquisition of control.

The situation of concern in the Technical itself is the effect of an acquisition of control on losses. However, an acquisition of control also triggers a year-end of the corporation. Besides having to file a tax return, a deemed year-end may have a number of other important consequences, including various limitation periods (e.g., the "179-day rule" for bonuses), filing deadlines for various tax elections, shareholder loan repayment deadlines, etc. Besides the impact on non-capital losses, a change-of-control could affect a number of other tax accounts.

Assuming that the Technical applies equally to estates, it seems to depart from a pre-existing benign administrative policy, as expressed in older technical interpretations[2] as well as Interpretation Bulletin IT-302R3, paragraph 10 of which indicates that:

Where an executor, administrator or trustee of an estate controls a corporation, it is a question of fact as to whether there is an acquisition of control of the corporation when there is a change of the executor, administrator or trustee. For purposes of paragraph 256(7)(a), where the executor, administrator or trustee is replaced as a result of that person's death or inability to fulfil his or her functions, the control of the corporation will be regarded as remaining unchanged. However, a change in executor, administrator or trustee together with a substantial change in the ownership of the beneficial interest in the estate will be considered an acquisition of control of the corporation.[3]

In contrast, in the Technical, the CRA concludes that: "it is our view that a change in *any* of the trustees would result in a new group controlling Lossco and, *subject to the provisions of paragraph 256(7)(a)*, an acquisition of control of Lossco".

Subsection 256(7) contains a number of "saving provisions" applicable to the change of control rules: unless one fits squarely into one of these, an acquisition of control will occur. While Situation 2 in the Technical deals with an amalgamation, which would be governed by the saving rule in paragraph 256(7)(b), it seems to me that the usual saving provisions in this sort of situation are clauses 256(7)(a)(i)(A) and (B), which deem control not to have been acquired solely because of the *acquisition* of shares of any corporation by a particular person who is related either to the transferor or to the particular corporation immediately before the time.[4] However, it is not completely clear whether these provisions can be relied on where the trustees of a trust or executors of an estate are simply replaced.[5]

The spectre of trustee replacement and its potential of adverse tax consequences is, of course, commonplace. Suppose, for example, there are three executor siblings of an estate that control a corporation. One of the siblings dies or resigns and is replaced by a non-related individual (this may often be a lawyer, accountant or

other professional advisor). Based on the Technical, it would appear that this would constitute an acquisition of control.^[6]

Obviously, the adverse tax consequences resultant from a change of trustees is inappropriate. Clearly, what is called for is a change in legislation to address this problem, perhaps the adoption of a provision similar to paragraph 256(1.2)(f) for the purposes of the acquisition of control rules.

Without this, the Technical greatly restricts the pre-existing administrative largesse, with fundamental and serious implications in many situations.

[1] Doc. No. 2004-0087761E5, May 24, 2005.

[2] See endnote 5 for further discussion.

[3] The pre-existing administrative policy was based upon wording of subsection 256(7) which was altered in the December 1992 Technical Amendments.

[4] Per paragraph 251(2)(b), such a person will be related to a corporation if: (i) he or she is a person who controls the corporation, if it is controlled by one person; (ii) is a member of a related group that controls the corporation; or (iii) is any person related to a person described in (i) or (ii).

[5] See also Heather L. Evans, "Recent Developments in the Taxation of Owner-Managed Businesses", 93 OC 8:30, in which the issue of trustee replacement is discussed, including two technical interpretations with a more benign policy: Doc. No. 9307165, July 28, 1993, and Doc. No. 9319425, August 6, 1993. However, the latter indicates that paragraph 256(7)(a) has no direct application as it envisages an acquisition (etc.) of shares of the corporation. The author observes:

While the comments with regard to the application of subsection 256(7) may be well-founded, the position regarding the acquisition of control in the circumstances described above would appear to have no basis in law and simply represents an administrative concession of uncertain application.

[6] Because the replacement trustee is unrelated to the siblings, he or she would not fit within the exceptions of clauses 256(7)(a)(i)(A) or (B), if applicable. Consideration might be given to not replacing the trustee in these circumstances. Query, however, the consequences if there are a number of unrelated trustees, e.g., Trustees A, B, and C, and one of them resigns or dies and is not replaced. Would there be an acquisition of control by a group – i.e., Trustee A and B? Doc. No. 9307165 seems to suggest that this may be the case.