

FACULTY OF LAW

FINAL EXAMINATION - April 16, 2003

LAW 660:Y5 ESTATE PLANNING (Sommerfeldt)

Time Allotted: Two (2) Hours Plus Ten (10) Minutes Reading Time

Code Number: **DO NOT ENTER YOUR NAME ON ANY ANSWER SHEETS OR BOOKLETS.** A list will be circulated and your name is to be entered opposite a number on that sheet. That number will be your code number **FOR THIS EXAMINATION ONLY** and should be entered on the examination booklets in the space provided for surname. This will provide for anonymity during marking.

- Special Instructions:**
1. This examination paper contains 5 questions on 7 pages. Check to ensure that the examination paper is complete before starting.
 2. Answer ALL questions.
 3. Questions are NOT of equal value. Apportion your time intelligently. A suggested time allotment (based on a proportionate allocation of the available time among the potential marks) is:

<u>Question</u>	<u>Marks</u>	<u>Time</u>
Reading Time		10 minutes
Q. 1	20	24
Q. 2	20	24
Q. 3	30	36
Q. 4	20	24
Q. 5	<u>10</u>	<u>12</u>
	100 marks	130 minutes

4. This is a **CLOSED BOOK** examination. However, you may use a clean, unmarked copy of the course syllabus (which is provided to you with this examination paper). You may also use *Stikeman Income Tax Act, Annotated* or a comparable edition of the *Income Tax Act (Canada)*, provided that it complies with the following guidelines:

- (a) portions of the book may be underlined, side-barred, shaded or otherwise highlighted in an unwritten manner;
 - (b) flags, stickies, etc. may be used to mark portions of the book, provided that the flags or stickies do not contain any written annotations other than references to sections or other provisions of the ITA; and
 - (c) no written annotations (other than those of the editor or publisher or those designating section numbers) may be placed in, or attached to, the book.
5. Adhere to the time limitation imposed on this examination strictly. Failure to stop writing at the end of the examination may lead to a deduction of grades or a failure to accept the examination paper.
6. Whereas it is very disruptive for those students finishing examinations while others are leaving the examination room and discussing the examination outside the examination door, it is requested that no individual leave the examination room during the last 15 minutes of the examination period.
7. All monetary amounts referred to in this examination paper are expressed in Canadian currency.
8. Unless otherwise stated, all individuals referred to in this examination paper are resident in Canada and all corporations referred to in this examination paper are taxable Canadian corporations.
9. Unless otherwise stated, all statutory references in this examination paper are references to the *Income Tax Act* (Canada) (the "ITA").

VALUE	QUESTION
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| 20 | 1. Dr. Nancy Ursula Skin is a dermatologist who carries on the practice of medicine in Edmonton through a professional corporation, known as N.U. Skin Professional Corporation (the "PC"), which was incorporated under the <i>Business Corporations Act</i> (Alberta). Dr. Skin is the sole officer, director and shareholder of the PC. She owns 100 Class A Shares (which are voting common shares) of the PC. The 100 Class A Shares of the PC have an adjusted cost base to Dr. Skin of \$100 (i.e., \$1 per share) and a fair market value of \$500,000 (i.e., \$5,000 per share). The stated capital (for corporate purposes) and the paid-up capital (for tax purposes) in respect of the Class A Shares of the PC are each \$100 (i.e., \$1 per share). Dr. Skin holds her Class A Shares of the PC as capital property. |
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Over the years, the PC has accumulated significant after-tax retained earnings, which the PC has invested in marketable securities. The marketable securities have generally increased in value, such that their current fair market value is well in excess of the adjusted cost base to the PC of those securities. Currently, the fair market value of the PC's medical practice and related assets is \$300,000 and the fair market value of the marketable securities is \$200,000. Accordingly, the fair market value of the PC's medical practice and related assets represents 60% of the value of all the assets of the PC and the fair market value of the marketable securities represents the other 40% of the value of all the assets of the PC.

Dr. Skin would like to purify the PC (to satisfy the requirement set out in paragraph (a) of the definition "qualified small business corporation share" in subsection 110.6(1) of the ITA) in anticipation of making use of the capital gains deduction in the event that she were ever to dispose of her shares of the PC. At the conclusion of the reorganization, Dr. Skin would like a new corporation ("Newco") to own the marketable securities and the PC to own only the medical practice and the related assets. Dr. Skin would like to be the sole shareholder of Newco and the sole shareholder of the PC.

Describe and discuss the steps to be followed in carrying out an appropriate purification reorganization in respect of the PC on a tax-deferred (or rollover) basis.

VALUE	QUESTION
20	<p>2. Paul Marlin owns 1,000 Class A Shares (which are voting common shares) of Canada Windships Inc. ("CWI"). The 1,000 Class A Shares of CWI have an adjusted cost base to Paul of \$1,000 (i.e., \$1 per share) and a fair market value of \$10,000,000 (i.e., \$10,000 per share). The stated capital (for corporate purposes) and the paid-up capital (for tax purposes) in respect of the Class A Shares of CWI are each \$1,000 (i.e., \$1 per share). Paul holds his Class A Shares of CWI as capital property.</p> <p>CWI is a Canadian-controlled private corporation, which was incorporated under the <i>Business Corporations Act</i> (Alberta). CWI's articles of incorporation authorize only one class of shares, i.e., the Class A Shares.</p> <p>Paul is currently the sole shareholder of CWI. However, he would like to find a tax-efficient way whereby his son, Tom, may acquire shares of CWI at a nominal price.</p>

While Paul is relatively well to do, he is only 50 years of age and anticipates that his current wealth will be insufficient to support him and maintain his current lifestyle for the remainder of his life. Accordingly, he would like to be in a position to receive half of the future income and growth in respect of CWI, while arranging for Tom to obtain the other half of the future income and growth in respect of CWI.

Paul would like to implement a corporate reorganization in respect of CWI to achieve his objectives. He prefers to own his shares of CWI directly, rather than through a holding company. Paul would like to maintain voting control of CWI. He does not want to incur any current tax liability in respect of the reorganization.

Paul has already utilized his full capital gains deduction in the context of prior dispositions of property unrelated to CWI.

Advise Paul of a plan whereby his objectives may be achieved. Discuss the steps that must be taken to implement the selected plan. Identify the provisions of the ITA that are applicable to the plan or that pose a pitfall.

VALUE	QUESTION
30	<p>3. Identify, describe and discuss the type of trust that should be used for each of the following situations. In your discussion, identify the relevant statutory provision that permits such a trust to be utilized or contemplates the use of such a trust and specify any statutory requirements set out in the ITA that must be met in order to create the desired type of trust.</p> <p>(a) Colleen and Ralph are married to each other. Colleen owns a hotel, which has increased significantly in value while she has owned it. Colleen holds the hotel as capital property. Colleen would like to provide in her will for the hotel to be transferred on a tax-deferred (or rollover) basis to a trust of which Ralph would be the life beneficiary and their children would be the residual beneficiaries.</p> <p>(This part of the question is worth 11 marks.)</p> <p>(b) Sam is a non-resident of Canada. Sam desires to acquire a parcel of real property on which there is a residential apartment building. He would like to be the beneficial owner of the property and the person entitled to the anticipated rental income, but would like to</p>

have legal title to the property registered in the name of Eagle Properties Inc. (“EPI”), which is an Alberta corporation that will hold the property for and on behalf of Sam. Sam owns all the issued shares of EPI. Sam does not want the trust to be recognized for tax purposes.

(This part of the question is worth 4 marks.)

- (c) Zeke is an elderly grandfather who has five very young grandchildren. Through his will, Zeke would like to settle a trust of which those five grandchildren would be the beneficiaries. Zeke proposes to bequeath \$50,000 to settle the trust. In his will, Zeke will instruct his executors and trustees to hold the \$50,000 as capital and to invest that money on behalf of the grandchildren. Zeke’s intention is that \$10,000 of the capital will be allocated to each grandchild and that all income earned by the trust will be allocated proportionately in favour of the grandchildren. Zeke does not want any income of the trust to be distributed to a grandchild until that grandchild has attained the age of 20 years. When a particular grandchild attains the age of 20 years, his share of any income earned by the trust thereafter is to be distributed to him on an annual basis. However, the income accumulated in the trust before the grandchild attains the age of 20 years is to be retained in the trust until he attains the age of 30 years, at which time the grandchild’s \$10,000 of capital and his accumulated income are to be distributed to that grandchild. Zeke would like the income of the trust to be taxed in the hands of the grandchildren, and not in the trust.

(This part of the question is worth 7 marks.)

- (d) Hilda, who is 66 years of age, has accumulated a number of investments. She would like to transfer her investments on a tax-deferred (or rollover) basis to a trust of which she would be the sole beneficiary during her lifetime and of which her son would be the trustee. She requires the income from the investments to meet her current living expenses. Hilda does not anticipate that she will require any of the capital of the trust during her lifetime; however, out of an abundance of caution, she would like to include a right of encroachment in the trust deed. Hilda’s objective is to avoid the administrative details and concerns of being the registered owner of the investments. As well, she would like to avoid probate fees in respect of those investments. She intends that, on her death, the trust will distribute the investments to her son.

(This part of the question is worth 8 marks.)

VALUE	QUESTION
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20	<p>4. Hank owns a block of publicly traded shares (the “Pubco Shares”), which have an aggregate adjusted cost base to him of \$80,000 and a current fair market value of \$100,000. Hank is married to Beth. Hank and Beth have two children, Jill (who is 10 years of age) and Bill (who is 8 years of age). The annual dividend income from the Pubco Shares is approximately \$4,000. Hank, who has other sources of income, would like to transfer the Pubco Shares on a tax-deferred (or rollover) basis to a new holding corporation (“Holdco”) of which his children (or a trust of which his children are the beneficiaries) would be the common shareholders. As consideration for the transfer of the Pubco Shares, Hank would like to receive from Holdco a promissory note (representing his initial investment in the Pubco Shares) and shares of Holdco.</p>
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Holdco will not own any property other than the Pubco Shares transferred to it by Hank. Apart from holding the Pubco Shares, Holdco will not engage in any other activities.

Hank is aware that, since his children (or a trust for them) will be shareholders of Holdco, care must be taken in selecting the class of shares to be issued to him by Holdco as partial consideration for the Pubco Shares. Hank is also aware that, if he transfers the Pubco Shares to Holdco, one of the attribution rules in the ITA could require an amount to be included in computing his income, regardless of the actual dividend income received by Holdco in respect of the Pubco Shares.

- (a) **Describe the type of transaction that should be used to transfer the Pubco Shares from Hank to Holdco on a tax-deferred (or rollover) basis. In particular, identify the statutory provision that would be applicable, the types of consideration that should be given by Holdco to Hank in exchange for the Pubco Shares and the nature and operative content of any document that must be filed with the Canada Customs and Revenue Agency to obtain tax-deferred (or rollover) treatment. Supplement your discussion with references to, and brief explanations of, the relevant paragraphs of the particular statutory provision.**

(This part of the question is worth 10 marks.)

- (b) **Identify the particular attribution rule (including the statutory reference) that could apply in this situation and**

describe the various techniques that are set out in the ITA that could be used to avoid, or reduce the impact of, that attribution rule. Discuss the steps that would have to be taken and the requirements that would have to be satisfied in order to obtain the tax consequences provided by each technique.

(This part of the question is worth 10 marks.)

VALUE	QUESTION
10	5. Compare and contrast a registered pension plan and a registered retirement savings plan (an “RRSP”). As well, explain how an RRSP may be used for future income splitting. In addition, note any pitfalls to be avoided when using an RRSP for future income splitting.

TOTAL MARKS: 100

End of Examination