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## Spousal and Common-Law Partner Trust Planning

by Marc Weisman

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When a taxpayer dies, tax laws dictate that the taxpayer is deemed to have disposed of all his/her capital property at fair market value. This will trigger capital gains (and recaptured depreciation), which are subject to income tax. (Capital property includes shares of private and public companies and real estate.)

However, if the taxpayer leaves the capital property to a spouse (which includes a common-law partner) or a "qualifying spousal trust" in a Will, any accrued capital gains (and recaptured depreciation) on the property will be realized on the death of the surviving spouse or when the spousal trust sells the property. This might provide a significant tax deferral.

What is a "qualifying spousal trust"? The individual's Will must provide that all of the income from the spousal trust be paid to the spouse (and none of the spousal trust's capital may be distributed to a beneficiary other than the spouse) during the spouse's lifetime. This applies only to the specific property left to the spouse or the trust; the taxpayer is free to divide up other capital property between other beneficiaries.

But supposing the individual and spouse wish to continue building up capital from the property, rather than paying out all of the property's annual income to the spouse? For example, they might want to reinvest dividends from public company shares or rent from an apartment building for the benefit of their children, while still qualifying for the tax-deferral. Such "asset building" may be particularly tax-effective if the individual's Will provides for the creation of subsequent 'springing' trusts for the children's benefit, on the death of the spouse.

A simple solution to this problem may be to place the income from the spousal trust in a holding corporation, owned by the spousal trust. Assets that would otherwise be held directly in the spousal trust would be transferred to a holding corporation in exchange for shares of the holding corporation on a tax-deferred basis, using a Section 85 rollover. All the future income would be earned within the holding corporation and not earned by the spousal trust unless distributed to it. As such, the spousal trust would not be earning any income and would therefore not be required to pay out the income to the spouse.

The holding corporation can recover Refundable Dividend Tax on Hand on the payment of dividends. To the extent that dividends from the holding corporation are not required during the spouse's lifetime, they can be paid out after the spouse's death, with less income tax if testamentary trusts for the children 'spring up' after the death of the spouse.

Torkin Manes' Tax and Trusts & Estates Groups work together to provide comprehensive tax and estate planning solutions for businesses and individuals. They have a significant practice working with other professional advisors such as financial planners and accountants to execute their clients' tax and estate plans.

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