TAB 17

Subsection 75(2) of the *Income Tax Act*

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The Six-Minute Estates Lawyer 2009

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Introduction

The *Income Tax Act* (Canada) (the "Act")[1] contains a series of attribution provisions designed to prevent income splitting among taxpayers. Where applicable, these provisions generally attribute any income or loss arising from the property and, depending upon the particular provision, any capital gain or capital loss incurred from the disposition of the property, to the transferor for purposes of the Act. Subsection 75(2) is an attribution provision of broad application which may be triggered inadvertently in circumstances where property is settled upon trust.

The attribution rules in subsection 75(2) may apply where property is received by an *inter vivos* trust in three circumstances: (i) the property (or property substituted therefor) may revert to the person from whom the property was received (the "settlor")[2], (ii) the property (or property substituted therefor) may pass to such beneficiaries as may be determined by the settlor subsequent to the creation of the trust, or (iii) the property cannot be disposed of except with the consent of the settlor or in accordance with the settlor's direction during his or her lifetime. Certain trusts are exempt from the application of subsection 75(2) pursuant to subsection 75(3) of the Act, including employee trusts and trusts governed by registered pension plans.

Where the application of subsection 75(2) is engaged, any income or loss from the particular property contributed by the settlor (or property substituted therefor) and any capital gain or

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* Presented at *The Six-Minute Estates Lawyer 2009*, Law Society of Upper Canada, April 6, 2009. The author gratefully acknowledges the assistance of Shannon Nelson of Davies Ward Phillips & Vineberg LLP in the research and preparation of this paper.

1 R.S.C. 1985 (5th Supp.), c. 1. Unless otherwise stated, all references to statutory provisions are references to the Act.

2 Subsection 75(2) can apply to any person from whom a trust receives property and is thus not limited to the settlor of a trust. In this paper, the use of the term "settlor" is, unless otherwise noted, intended to include any person that contributes property to a trust, including a corporation.

capital loss resulting from the disposition of such property will be attributed to the settlor for purposes of the Act. However, as subsection 75(2) applies on a property-specific basis, not all of the income, gains or losses of a trust will necessarily be attributed to a settlor, such as in circumstances where the trust has received property from multiple contributors or where only a portion of the property contributed by the settlor satisfies the preconditions for the application of subsection 75(2).

Once triggered, the attribution resulting from the application of subsection 75(2) may be "cured" so as to prevent future attribution by, for example, altering the number or identity of trustees. While the resultant attribution consequences themselves may not therefore be significant in any particular circumstance, the most detrimental consequence arising from the application of subsection 75(2) of the Act to the trust may not in fact result from the attribution of income or capital gains, but rather from the application of another provision of the Act, subsection 107(4.1). Where subsection 75(2) has applied to property of a trust at any time, the tax-deferred rollout of the property of the trust at its tax cost that is generally available under subsection 107(2) of the Act in respect of capital distributions made to Canadian resident beneficiaries may be denied for distributions made to certain capital beneficiaries pursuant to subsection 107(4.1) of the Act. Furthermore, once subsection 107(4.1) has applied to a trust, its effect may not be alleviated and the provision may continue to apply in respect of future capital distributions made prior to the death of the settlor or, in the case of a corporate settlor, until the corporation is no longer in existence.

This paper considers the structure and application of subsections 75(2) and 107(4.1), with a particular focus on the interpretation of the provisions of subsection 75(2) in the context of a settlor of a trust acting as one of two trustees of the trust. It concludes that subparagraph 75(2)(a)(ii) of the Act, which may attribute income, gain or loss where the settlor retains the power to determine the capital beneficiaries that may receive the contributed property subsequent to the settlement of the trust, and paragraph 75(2)(b), which may apply where the settlor retains the power to prevent or direct the disposition of the contributed property, should not be applicable where the settlor is one of two trustees, acting in a fiduciary capacity as trustee and not in his or her personal capacity, to decide issues under standard terms of the trust that require unanimity in these circumstances, or that are otherwise silent as to trustee decision-making.

Application of Subsection 75(2)

Subsection 75(2) of the Act states as follows:

> "**75(2) Trusts [revocable, etc.]** – Where, by a trust created in any manner whatever since 1934, property is held on condition
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> (a) that it or property substituted therefor may
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> (i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as 'the person'), or
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> (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
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> (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,
>
> any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person."

The potential breadth of application of subsection 75(2) is readily apparent from its plain reading. As subsection 75(2) will apply to any "person from whom the property or property for which it was substituted was directly or indirectly received", it may apply to any person that contributes property to a trust, including a corporation, and is not limited to a settlor of a trust.[3] Several aspects of subsection 75(2) materially differ from other attribution provisions in the Act and contribute to its broad application. Subsection 75(2) may apply to attribute income, gain or loss from property, regardless of whether: (i) the settlor and the beneficiaries deal at arm's length,[4] (ii) the settlor intends to reduce income or benefit another person,[5] (iii) the income or

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[3] See *Interpretation Bulletin* IT-369R, "Attribution of Trust Income to Settlor" (March 12, 1990), as amended by Special Release dated 24 June 1994 at para. 11 [IT-369R].

[4] See, for example, subsection 74.1(2) of the Act, which attributes any income or loss from property that was transferred or lent to a minor who does not deal at arm's length with the transferor or is the transferor's niece or nephew.

gain is in fact paid or distributed to the settlor,[6] or (iv) the settlor receives fair market value consideration for the transferred property.[7] Furthermore, Canada Revenue Agency (the "CRA") has stated that in its view subsection 75(2) may apply to a transfer of property to a trust where the settlor retains the right to reacquire the property at its fair market value.[8]

Limitations on Application

Although subsection 75(2) is phrased broadly, the provision does contain some inherent limitations on its application, including the qualification that income, gain or loss will only be subject to attribution while the settlor is alive and resident in Canada. Consequently, subsection 75(2) will not apply to the trust following the death or emigration of the settlor.

The interest and powers that a settlor is precluded from retaining following the settlement of a trust in order to avoid application of the provision relate only to the capital interest in the contributed property. It may be possible for the settlor to be a capital beneficiary in respect of other trust property or an income beneficiary, or to retain control over the allocation or distribution of trust income, without attracting application of subsection 75(2).

Where subsection 75(2) applies to property of a trust, the income or loss attributable to the settlor is limited to "any income or loss from the property or from property substituted for the property" and thus does not include income or loss from a business.[9] Nevertheless, it appears that any capital gain or loss from the disposition of such property may be attributed to the settlor. Second-generation income, such as compound interest on accumulated interest earned on funds

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5 See, for example, subsection 74.4(2) of the Act, which operates to attribute interest to individuals that transfer or loan property to corporations in certain circumstances.

6 See, for example, subsection 74.1(1) of the Act, which attributes income or loss of the spouse or common-law partner of a transferor or lender.

7 See, for example, subsection 74.5(1) of the Act, which provides that subsections 74.1(1) and (2) and section 74.2 do not apply to attribute any income, gain or loss where the fair market value of the transferred property does not exceed the fair market value of the property received by the transferor in consideration therefor.

8 See CRA Document No. 2002-0118255, "Application of 75(2)" (June 10, 2002).

9 See IT-369R, *supra* note 3 at para. 5. CRA states that subsection 75(2) will not apply to the income or loss of a business, even where the property used to operate the business includes property received from the settlor.

received by the trust from the settlor, is not subject to attribution under subsection 75(2).[10] Since subsection 75(2) will apply to substituted property, any capital gains or losses realized by the trust on dispositions of substituted property may also be attributable to the settlor.

Finally, CRA has confirmed in a technical interpretation that where property is transferred from one trust to another, subsection 75(2) will not be applicable to the second trust merely because of the application of subsection 75(2) to the first trust.[11] As a practical matter, however, this planning may be difficult to achieve in light of subsection 248(25.1) of the Act, which can apply to deem the transferee trust to be the same trust as, and a continuation of, the transferor trust for purposes of the Act where the transfer does not constitute a "disposition" of the trust property for income tax purposes.[12]

Reversionary Trusts

Subparagraph 75(2)(a)(i) of the Act can apply where the settlor is a capital beneficiary of a trust or otherwise retains the right to reacquire the contributed property (or property substituted therefor). In a recent technical interpretation, CRA emphasized the use of the word "may" in subparagraph 75(2)(a)(i) and the lack of any notion of control or certainty, reasoning that the provision would thus apply even where there is only a possibility that the property will revert to the settlor.[13] Similarly, CRA has stated that, in its view, subparagraph 75(2)(a)(i) may apply even where the possibility of reversion is remote.[14]

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10 *Ibid.* at para. 6.

11 See CRA Document No. 2001-0067955, "Application of 75(2) and 107(4.1) to a Trust" (January 3, 2002). Although subsection 75(2) will not necessarily apply to the second trust, subsection 107(4.1) applies to any distribution of property where subsection 75(2) was applicable at any time in respect of property held by the trust. Subsection 107(4.1) will thus apply to the second trust unless (i) the beneficiary is the contributor or the contributor's current or former spouse or common-law partner, or (ii) the contributor is not alive at the time of distribution.

12 In this regard, see also subparagraph 107(4.1)(b)(ii) of the Act, which may have the same effect where the transferee trust received the property on a rollover basis by way of a qualifying disposition pursuant to subsection 107.4(3).

13 See CRA Document No. 2003-0050671E5, "Attribution of Property Transferred to a Trust" (April 5, 2004) [CRA Doc. No. 2003-0050671E5].

14 See, for example, CRA Document No. 9304585, "Attribution – Meaning of Meaning of 'Revert'" (May 17, 1993) [CRA Doc. No. 9304585]; CRA Document No. 9332575, "Attribution of Income" (January 27, 1994) [CRA Doc. No. 9332575].

Until recently, there was little authority concerning the issue of whether a loan made to a trust would be considered to revert to the creditor and thus potentially trigger the application of subparagraph 75(2)(a)(i) of the Act. CRA's administrative position was that provided the loan was outside of and independent of the terms of the trust, a genuine loan would not constitute property "held" by the trust such that subsection 75(2) would not apply in these circumstances.[15] The following conditions were generally required by CRA to evidence a "genuine loan": (i) the borrower's written and signed acknowledgment of the loan and an agreement for repayment within a reasonable period of time, (ii) the provision of security, (iii) the payment of interest, and (iv) repayment of the loan.[16] Although these requirements may be reasonable in a commercial context, it was often impractical to require that they be satisfied in the context of a family trust, particularly where the lender was a beneficiary under the trust.

In *Howson v. The Queen*,[17] the Tax Court of Canada considered whether funds received by a family trust constituted a loan, in which event the attribution rules in subsection 75(2) would not be applicable. When Mr. and Mrs. Howson immigrated to Canada from South Africa, a trust was established, the beneficiaries thereof being Mr. and Mrs. Howson and their children, to take advantage of the available 60-month tax exemption for immigration trusts. Mrs. Howson advanced funds to the trust as a loan on an oral agreement which was not, other than in the financial statements of the trust, documented until three years subsequent to the advance being made. Although no interest was paid, the loan agreement provided for its payment if so required and stipulated that the loan would be repaid within 10 years from the date of the advance. Justice Miller held that the funds were contributed to the trust by way of loan even though there was no contemporaneous legal documentation in respect of the advance, provision of security or payment of interest. The Crown conceded that subsection 75(2) would not be applicable if the money was found to have been advanced to the trust by way of loan, and Justice Miller confirmed that loans are not subject to attribution under subsection 75(2) of the Act, concluding that "[i]t stands to reason that a *bona fide* loan is, on its face, not subject to reversion by the

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15 See IT-369R, *supra* note 3 at para. 1.

16 See CRA Document No. 2007-0240421C6, "2007 STEP Conference – Q. 4 – 75(2) Loans and the *Howson* Decision" (June 8, 2007) [CRA Doc. No. 2007-0240421C6].

17 2007 DTC 141 (TCC) [*Howson*].

terms of the Trust. It returns to the lender by operation of the loan itself and the law of creditor rights."[18]

CRA issued a qualified change in its administrative position following the *Howson* decision. In commenting on its interpretation of the court's reasons for judgment in *Howson*, to the effect that a loan returns to the lender by operation of the loan itself and the law of creditor rights and that neither interest nor security are necessary components of a loan, CRA stated as follows:[19]

> "To the CRA these comments mean that something called [a] loan must be regarded as a loan at law. As acknowledged by the Court in *Howson*, although property held by a trust pursuant to a *bona fide* loan will eventually revert to the creditor, given that such reversion will usually not flow from the terms of the trust but by operation of the loan itself and the law of creditor rights, it follows that such property should not be subject to subsection 75(2) of the ITA. Therefore, absent the particular scenario where a loan to a trust is not outside and independent of the terms of the trust, we are of the view that a loan to a trust falls outside the ambit of subsection 75(2) of the ITA and should rather be dealt with under subsections 56(4.1) and 74.1(1) to (3) of the ITA."[20]

Where property may revert to a settlor by operation of law, such as by way of resulting trust due to "total failure of the trust for lack of beneficiaries, and not pursuant to any condition under the trust indenture"[21] or "impossibility of purpose"[22], CRA has concluded that subparagraph 75(2)(a)(i) will not normally be applicable, notwithstanding its position that the provision will apply where the terms of the trust provide for the reversion of the property to the settlor upon the death of all other trust beneficiaries.[23] If the settlor's spouse has an unrestricted general power of appointment exercisable by will to distribute the property of the trust, CRA takes the position that because the settlor could be appointed as a capital beneficiary, resulting in the potential

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18 *Ibid.* at 144.

19 CRA Document No. 2007-0240421C6, *supra* note 16.

20 *Ibid.*

21 See CRA Document No. 9332575, *supra* note 14.

22 See CRA Document No. 9304585, *supra* note 14.

23 *Ibid.*

reversion of the contributed property to the settlor, subsection 75(2) of the Act will apply.[24] In contrast, where the estate of a settlor's spouse acquires the property, subsection 75(2) will not apply, even though there is a possibility of reversion to the settlor through the spouse's will.[25]

Subsection 107(4.1) of the Act

Generally, where a personal trust distributes property to a capital beneficiary who is resident in Canada, the trust's proceeds of disposition in respect of the property will be deemed to be equal to the cost amount of the property to the trust pursuant to subsection 107(2) of the Act. However, the tax-deferred rollout of property by a personal trust may be denied to the extent that subsection 75(2) has applied to the trust by virtue of subsection 107(4.1) of the Act.

The requisite preconditions to the application of subsection 107(4.1) to a distribution of property to a beneficiary are as follows: (i) the distribution is in satisfaction of all or part of the beneficiary's capital interest in the trust, (ii) the attribution rules in subsection 75(2) have applied to the particular trust or another trust, the property of which has been transferred to the particular trust pursuant to a qualifying disposition under subsection 107.4(3), (iii) the beneficiary is not the settlor or the settlor's current or former spouse or common-law partner, and (iv) the settlor is in existence at the time of the distribution.

Where subsection 107(4.1) applies to a distribution, subsection 107(2.1) of the Act will apply to determine the tax consequences of the distribution, such that: (i) the trust will be deemed to have received proceeds of disposition for the distributed property in an amount equal to the fair market value of the property, (ii) the beneficiary will be deemed to have acquired the distributed property at a cost equal to its fair market value, and (iii) the beneficiary will be deemed to have disposed of the beneficiary's capital interest in the trust for an amount equal to the fair market value of the property received net of any capital gain realized by the trust.

Subsection 107(4.1) is a provision of broad application. First, it applies to the trust itself, unlike subsection 75(2) which is applicable in respect of specific property of the trust, resulting in the

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[24] See CRA Document No. 2003-0050671E5, *supra* note 13. CRA further suggested that the application of subparagraph 75(2)(a)(ii) can be avoided by limiting the donee's ability to appoint the settlor as a capital beneficiary or otherwise allowing the property to revert to the settlor.

[25] CRA Document No. 2002-0139205, "Subsection 75(2) Arising as Consequence of a Will" (July 22, 2002).

continued application of subsection 107(4.1) to a trust even after subsection 75(2) ceases to apply to its property.[26] Once subsection 75(2) has applied to a trust, any capital distribution may nevertheless be subject to the application of subsection 107(4.1) where the other preconditions to the application of that provision are met. Second, the application of subsection 75(2) to a trust prior to subsection 107(4.1) entering into force were not grandfathered when subsection 107(4.1) was enacted, effectively resulting in its retroactive application. Third, although subsection 75(2) requires a settlor to be resident in Canada in order for any income, gain or loss from contributed property to be attributable, subsection 107(4.1) lacks a corresponding requirement, such that it may continue to apply even after a settlor emigrates from Canada. Fourth, the language of subsection 107(4.1) requiring that "subsection 75(2) was applicable at a particular time in respect of any property of [the trust]" does not explicitly state that any income, gain or loss must have actually been attributed to the settlor, and has in fact been interpreted administratively by CRA so as to deny a tax-deferred rollout of property to a capital beneficiary even where subsection 75(2) has been triggered in the absence of any resulting attribution.[27] The potential breadth of application of subsection 107(4.1) may therefore require a complete review of a trust's history to determine whether subsection 75(2) was ever applicable to property of the trust, even where a trust holds only non-income producing assets, prior to a distribution of trust property to its capital beneficiaries.

The only statutory limitations to the application of subsection 107(4.1) are that the provision will not apply to dispositions of property that occur after the death of the settlor or to dispositions made to the settlor or the settlor's current or former spouse or common-law partner of property contributed by them (or property substituted therefor). Accordingly, once subsection 75(2) of the Act has applied to a trust, distributions made to other capital beneficiaries thereunder that could otherwise have been effected on a rollover basis may be taxable if the distribution occurs prior to the death of the settlor.

CRA does permit the identification of property to be distributed where the trust holds identical properties, only some of which were contributed by the settlor, such that subsection 107(4.1) will

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26 See CRA Document No. 9207365, "Attribution" (July 22, 1992) [CRA Doc. No. 9207365].

27 *Ibid.*

not necessarily apply to such distributions.[28] However, CRA has stated that where the purpose of such a distribution is to shift the cost base of the properties among contributors, it may seek to apply the general anti-avoidance rule in section 245 of the Act.

Settlor Acting as One of Two Trustees

Subparagraph 75(2)(a)(ii) and paragraph 75(2)(b) may both be applicable where the requisite control over the trust property contributed to the trust is retained by the settlor. While these provisions should have no application if the settlor is one of three trustees at all times with decision-making made by majority and where the trust indenture neither requires the settlor to form part of any such majority nor accords to the settlor veto rights in respect of distributions of trust property to beneficiaries, one issue that frequently arises in this context is whether these provisions may apply where a settlor of a trust acts as one of two trustees thereof. Absent a specific express requirement under the terms of the trust that the settlor, acting in his personal capacity (as opposed to in his capacity as trustee), approve trustee decisions or otherwise be required to form part of any majority for decision-making purposes, it appears that subsection 75(2) of the Act should be interpreted so as not to apply solely by virtue of the settlor of the trust acting as one of two or more trustees of the trust, where trustee decisions are to be made unanimously or by a simple majority of the trustees, or where the trust terms are otherwise silent as to trustee decision-making.

Subparagraph 75(2)(a)(ii) requires, as a precondition to its application, that trust property be held on condition that it or property substituted therefor may pass to persons to be determined by the person from whom the property (or property for which it was substituted) was directly or indirectly received at a time subsequent to the creation of the trust. On the basis of a literal reading of this provision, it arguably should not generally apply in circumstances where there is more than one trustee, even where trustee decisions require unanimity, unless the settlor is otherwise expressly granted the right to make such determinations alone pursuant to the specific terms of the trust. In particular, in these circumstances, the settlor would generally be unable to determine, acting alone, the person or persons to whom any property held on trust may be

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[28] See CRA Document No. 9215065, "Rollout of Identical Properties from Reversionary Trust" (August 7, 1992).

distributed. Any decision made by the settlor in this regard could be subject to veto by his or her co-trustee or trustees.

In contrast, paragraph 75(2)(b) may apply if the property is held on condition that, "during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction". While this provision may therefore apply in the context of an effective veto right or similar element of negative control pursuant to the terms of the trust, the statutory wording appears to explicitly distinguish between the consent or direction of the settlor exercisable in his personal capacity as such, and such decisions as may be made by the settlor in his capacity as a trustee or fiduciary under the trust.

By specifically limiting the application of paragraph 75(2)(b) to veto or negative control rights exercisable "during the existence of the person", the statutory language indicates the intention that it apply only in circumstances where the terms of the trust provide for such powers to be exercisable by the settlor in his personal capacity, and not in his capacity as a fiduciary or trustee. This indication is reflected in the emphasis on the person's requisite consent or direction while in existence, such that the statutory language is suggestive of powers exercisable in a personal capacity rather than as trustee. This reading of the provision is strengthened by the fact that the part of subsection 75(2) after paragraph 75(2)(b) again specifically limits attribution of income, gain or loss from the contributed property, such that it applies only "during the existence of the person while the person is resident in Canada". It would arguably have been unnecessary, as a matter of statutory drafting, to reflect this specific condition in paragraph 75(2)(b) of the Act unless it was intended to convey that the reference to the retained powers of the settlor or contributor be limited to those exercisable in his or her personal capacity.

Based on this interpretation, the mere fact that the settlor, by virtue of the terms of the trust (or an absence of express terms relating to trustee decision-making) requiring unanimous consent in respect of all decisions, effectively retains a veto right over any distribution decisions in his capacity as one of two trustees of the trust, should not result in the application of paragraph 75(2)(b) of the Act. This may be contrasted with a circumstance in which the settlor is required, pursuant to the specific terms of the trust, to form part of any majority of trustees for decision-making purposes or the terms of the trust state expressly that the settlor must consent to any such

decisions. In this event, the property of the trust could not be disposed of except with the consent or in accordance with the direction of the settlor, acting in his or her personal capacity, as opposed to as a trustee or fiduciary.

CRA's Administrative Positions

In its administrative positions concerning the application of subparagraph 75(2)(a)(ii) and paragraph 75(2)(b), CRA appears to have accepted this approach to the application of the provisions as a matter of statutory interpretation.

In particular, while it had originally adopted a contrary position[29], CRA has reversed its earlier views and has consistently held in its more recent technical interpretations and published rulings that subsection 75(2) of the Act should not apply to a trust solely by virtue of the fact that the settlor is one of two or more trustees, acting in their fiduciary capacity to decide issues by majority, or where standard terms of the trust require the decisions of the trustees to be unanimous.

In its most recent statement on this issue, for example, CRA stated as follows:

> "Recognizing that it is a question of fact as to whether the terms of a particular trust have been so conditioned as to enable the settlor to determine, after the creation of the trust, who will receive the trust property, the fact that the settlor is one of two or more trustees, acting in their fiduciary capacity to decide issues by majority will not normally, in and by itself, give rise to the application of subsection 75(2) of the Act. It could still apply however where the terms and conditions of a trust expressly require the contributor's consent to any decision made by the trustees as a whole. This would include the situation where decisions are made by a majority of trustees provided that the trustee-contributor is one of that majority but would not include the situation where the terms of the trust require the decisions of the trustees to be unanimous. Thus a determination of whether this condition is met in respect of any particular property can only be made on a case-by-case basis following a review of all the facts and circumstances surrounding a particular situation, including a review of the complete trust indenture."[30]

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29 See, for example, CRA Document No. 9407905, "Reversion of Trust Property" (June 6, 1994).

30 See CRA Document No. 2008-0292061E5, "Application of Subsection 75(2)" (October 27, 2008).

CRA has similarly consistently adopted the position that subsection 75(2) of the Act will apply in circumstances where the settlor of a trust is the sole trustee, and has taken the position that both subparagraph 75(2)(a)(ii) and paragraph 75(2)(b) of the Act will be engaged in these circumstances. In the same technical interpretation, for example, CRA stated as follows:

> "Where the settlor or other contributor is the sole trustee of the trust, none of the trust's property can be disposed of without the settlor's consent or direction. As a result of the settlor's direct control over the property transferred to the trust, it is our view that property transferred to the trust by the settlor is held on the condition described in paragraph 75(2)(b) such that subsection 75(2) would apply even though the settlor's ability to control the disposition of the trust property is maintained by his or her position as a trustee. Likewise, where the terms of the trust allow the trust property to pass to persons determined by the trustee and the person who contributed the property is the sole trustee of the trust, subparagraph 75(2)(a)(ii) will apply."[31]

Accordingly, while CRA maintains that paragraph 75(2)(b) of the Act will apply when, under the terms and conditions of the trust indenture, provision is made to the effect that the specific consent of the settlor of the trust is required in connection with any decision the trustees make concerning the disposition of the trust property, it has clearly distinguished, in applying paragraph 75(2)(b), between the consent or direction of the settlor acting in his personal capacity, which in CRA's view will generally result in the application of the provision, and standard trust provisions that would by their terms require unanimity in circumstances where, for example, there are only two trustees of the trust, in which circumstance the provisions will not apply.

While CRA's statements regarding the application of paragraph 75(2)(b) of the Act do appear inconsistent insofar as they relate to a single trustee acting in his or her capacity as trustee, because subparagraph 75(2)(a)(ii) could potentially apply in any event in this circumstance, it appears that CRA's conclusion as to the application of subsection 75(2) more generally may be correct, despite its reasoning as applied in the context of paragraph 75(2)(b).

CRA's position with respect to the application of paragraph 75(2)(b) as set out in the above technical interpretation is consistent with other recent administrative statements made by it. It

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[31] *Ibid.*

has, for example, stated as follows:

> "Generally speaking, when no specific provision is made in a trust indenture as to the way in which the trust's property must be administered, the administration of this property is subject to the standard terms in the trust indenture. In this case, the fact that an individual from whom the trust received property is a co-trustee of the trust with one or more individuals and the trustees' decisions must be made by a majority or unanimously does not in and of itself mean that paragraph 75(2)(b) applies. However, paragraph 75(2)(b) will apply when, among other things, under the terms and conditions of the trust indenture, specific provision is made that the consent of the settlor of the trust or any other person who contributed property to the trust is required in connection with any decision the trustees make concerning the disposition of the trust's property."[32]

CRA has similarly stated in another interpretation:

> "It is a question of fact as to whether property is held by a trust under either of the conditions described in paragraphs 75(2)(a) or (b). When the settlor is one of two or more co-trustees acting in a fiduciary capacity in administering the trust property and there are no specific terms outlining how the trust property is to be dealt with, but rather the property is subject to standard terms ordinarily found in trust indentures, we accept that paragraph 75(2)(b) will generally not be applicable.
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> With respect to the condition described in subparagraph 75(2)(a)(ii), it is a question of fact as to whether the settlor can, after the creation of the trust, determine who will receive the property from the trust. Where the beneficiaries under a trust are named in the trust indenture and cannot be modified (i.e., the settlor cannot select additional beneficiaries after the creation of the trust), subparagraph 75(2)(a)(ii) is generally not considered applicable. This is true even though the settlor may be able to determine the amount of the trust property that is to be distributed to the beneficiaries already identified in the trust documents. However, subparagraph 75(2)(a)(ii) is worded broadly and there could be exceptions to this general position depending on the particular arrangement. When the settlor is one of two or more co-trustees acting in a fiduciary capacity in administering the trust property and there are no specific terms outlining how the trust

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[32] CRA Document No. 2004-0086921C6, "Subsection 75(2): Application of S. 75(2)(b) – Contributing Co-Trustee" (October 8, 2004).

> property is to be dealt with, but rather the property is subject to standard terms ordinarily found in trust indentures, we accept that paragraph 75(2)(a)(ii) is also not generally applicable."[33]

CRA's administrative position concerning these provisions thus appears to be consistent with the approach to statutory interpretation of subparagraph 75(2)(a)(ii) and paragraph 75(2)(b) of the Act set out above.

Conclusion

It is clear that subparagraph 75(2)(a)(ii) and paragraph 75(2)(b) of the Act should have no application where the settlor is one of three trustees at all times, with decision-making to be made by majority, and where the trust indenture does not require the settlor to form part of the majority or provide the settlor with any veto rights in respect of distributions made to the beneficiaries.

Where, however, the settlor is only one of two trustees, acting in their fiduciary capacity, to decide issues under standard terms of the trust that require the decisions of the trustees to be made by majority or to be unanimous, or are otherwise silent as to trustee decision-making, and in particular do not expressly require the settlor's consent to any decision made by the trustees or that the settlor form part of any majority for decision-making purposes, these provisions similarly should not apply. This conclusion appears to be consistent with CRA's recent administrative statements concerning the application of subsection 75(2) of the Act.

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[33] CRA Document No. 2003-0050671E5, *supra* note 13. See, to similar effect, CRA Document No. 1999-0013085, "Attribution Where Settlor is a Trustee" (August 1, 2002), and CRA Document No. 1999-0013055, "75(2)(b) Where Settlor is Sole Trustee" (June 20, 2002).

Subsection 75(2) of the *Income Tax Act*

DAVIES

April 6, 2009

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Subsection 75(2)

- Attribution of income and loss, capital gains and losses
- 75(2)(a)(i) – property can revert to settlor
- 75(2)(a)(ii) – settlor can determine at subsequent time who receives distributions of trust property
- 75(2)(b) – property cannot be disposed of without consent or direction of settlor
- Subsection 107(4.1) – denial of tax-deferred rollout to certain beneficiaries where subsection 75(2) has applied
- Must therefore be considered in context of most estate planning even though not generally applicable in context of testamentary trusts

DAVIES

Settlor as One of Two Trustees

- Subsection 75(2) has no application if settlor is one of three trustees with decision-making by majority where settlor not required to form part of majority and no veto rights concerning distributions
- Settlor as one of two trustees
- Standard terms of trust require decisions to be made by majority or to be unanimous, or are otherwise silent as to trustee decision-making
- No express requirement that settlor consent to any decision made by trustees or form part of any decision
- Application of ss. 75(2)(a)(ii) or 75(2)(b)?

DAVIES

CRA Administrative Position

- CRA document number 2008-0292061E5, "Application of Subsection 75(2)", dated October 27, 2008:

  "Recognizing that it is a question of fact as to whether the terms of a particular trust have been so conditioned as to enable the settlor to determine, after the creation of the trust, who will receive the trust property, the fact that the settlor is one of two or more trustees, acting in their fiduciary capacity to decide issues by majority will not normally, in and by itself, give rise to the application of subsection 75(2) of the Act. It could still apply however where the terms and conditions of a trust expressly require the contributor's consent to any decision made by the trustees as a whole.

DAVIES

CRA Administrative Position (cont'd)

This would include the situation where decisions are made by a majority of trustees provided that the trustee-contributor is one of that majority but would not include the situation where the terms of the trust require the decisions of the trustees to be unanimous. Thus a determination of whether this condition is met in respect of any particular property can only be made on a case-by-case basis following a review of all the facts and circumstances surrounding a particular situation, including a review of the complete trust indenture."

Subparagraph 75(2)(a)(i)

75(2). "Where, by a trust created in any manner whatever since 1934, property is held on condition

(a) that it or property substituted therefor may

(i) *revert to the person from whom the property or property for which it was substituted was directly or indirectly received* (in this subsection referred to as 'the person'), or …

DAVIES

Subparagraph 75(2)(a)(ii)

(a) that it or property substituted therefor may

...

(ii) *pass to persons to be determined by the person at a time subsequent to the creation of the trust,* or ...

Paragraph 75(2)(b)

Where, by a trust created in any manner whatever since 1934, property is held on condition

...

(b) that, *during the existence of the person*, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,

DAVIES

Subsection 75(2) – Postamble

…any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, *during the existence of the person while the person is resident in Canada*, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person."

DAVIES

Settlor as One of Two Trustees

- 75(2)(a)(ii) – settlor unable to determine, acting alone, persons to whom any property held on trust may be distributed; subject to veto by co-trustee or trustees
- 75(2)(b) – statutory wording appears to distinguish between consent or direction of settlor acting in personal capacity and such decisions as may be made by settlor in capacity as a trustee or fiduciary of the trust
- Applies only "during the existence of the person"
- Contrast where settlor is required pursuant to specific terms of trust to form part of any majority or consent to any such decisions