

# Trusts, Wills, Estates and Charities Bulletin

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## Transactions to Minimize the Tax Implications of the Twenty-One-Year Rule for Trusts

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For income tax purposes, trusts are generally deemed to dispose of their capital property every 21 years following their creation, resulting in the realization of accrual gains and losses. Given the recent financial crisis and its negative financial implications, the value of common shares of an operating corporation that is owned by a trust may have a nominal value at this time. However, this situation may be beneficial for a trust who wishes to avoid the 21-year deeming rule. To achieve this goal, the suggested transaction provides first that common shares be redeemed by the company. Second, a new trust is created to acquire the common shares of the same corporation. By proceeding as such, the 21-year rule period would be refreshed and a new period of 21 years would start at the moment of the creation of the new trust. If the trust was created many years ago, such deemed disposition will be postponed for many years.

On the other hand, if the common shares of a corporation that are owned by a trust have a significant value and the desired result is to have future growth accrue to a new trust, we could proceed by a freeze transaction. In that context, the corporation's common shares are frozen in exchange of non voting preferred shares and a new trust is formed to acquire the common shares of the corporation. The frozen shares are then

rolled out from the first trust to its beneficiaries. If the shares involved are shares of a qualifying small business corporation, the capital gain exemption could also be crystallized as part of this transaction.

However, the freezor who implements the freeze transaction may wish to maintain the existing trust while at the same time lowering or eliminating the potential tax implication of the 21-year rule period. Thus, to that effect, the trust could immediately before its 21<sup>st</sup> anniversary exchange its common shares with accrued gains of the corporation on a tax-deferred rollover basis for fixed-value preferred shares and subscribe to new common shares. The trust would then distribute the preferred shares prior to its 21<sup>st</sup> anniversary to its beneficiaries on a tax-deferred basis and the trust's new common shares should have nominal value at its 21<sup>st</sup> anniversary.

For more information, please contact the author, or any of the other members of our Trusts, Wills, Estates and Charities group.

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