GST and Business Trusts: Filling the Gaps

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PRÉCIS

La législation sur la taxe sur les produits et services n'accorde qu'une attention superficielle à la taxation des fiducies. De plus, la manière dont la législation devrait s'appliquer à l'établissement d'une relation de fiducie, aux activités continues des fiducies et à la distribution des biens de la fiducie est loin d'être claire.

Dans cet article, les notions juridiques fondamentales d'une fiducie et d'une succession sont examinées afin d'établir un cadre pour l'application de la législation. Chaque aspect des opérations auxquelles participent des fiducies et des successions est ensuite examiné dans le cadre des dispositions de la taxe sur les produits et services. Selon cette analyse, il existe de nombreuses lacunes ou questions sans réponse. Les auteurs proposent des solutions à ces questions. Les principales préoccupations ont trait à l'indentification et à la taxation d'une «simple fiducie», à la distinction, s'il en est, entre la taxation d'une fiducie et d'une succession, aux exigences d'enregistrement, au droit aux crédits de taxe sur les intrants et au chevauchement des dispositions législatives.

Cet article a été rédigé selon la loi et la politique administrative en vigueur le 31 janvier 1996.

Note des auteurs : Le 23 avril 1996, le ministère des Finances a publié un document sur la réforme de la TPS contenant les nombreuses propositions de modifications législatives. Ce document comprend les modifications aux articles 267 et 269 et à d'autres dispositions de la Loi sur la taxe d'accise qui règlent certaines des questions soulevées dans cet article.

ABSTRACT

The goods and services tax (GST) legislation gives only cursory attention to the taxation of trusts. Moreover, it is far from clear how the legislation should apply to the establishment of the trust relationship, to ongoing trust activities, and to the distribution of trust property.

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This article examines the basic legal concepts of a trust and an estate to set the framework for application of the legislation, then examines each aspect of transactions involving trusts and estates within the context of the goods and services tax provisions. This analysis indicates numerous gaps or unanswered questions, and the authors attempt to postulate solutions to these difficulties. The primary issues relate to the identification and taxation of a "bare trust," the distinction (if any) between the taxation of a trust and an estate, the registration requirement, entitlement to input tax credits, and the overlap of legislative provisions.

This article reflects the law and administrative policy as at January 31, 1996.

Authors' note: The Department of Finance released a GST reform package on April 23, 1996 containing numerous proposed legislative amendments. Included in this package are amendments to sections 267 to 269 and other provisions of the Excise Tax Act which address certain of the issues raised in this article.

INTRODUCTION

New Complexities

Amendments to the Income Tax Act[1] in past years have curtailed some of the advantages of a trust as a form of business organization.[2] Nevertheless, some business ventures are intentionally carried on through such a vehicle. "Bare trusts" may be encountered in various commercial contexts, such as real property transactions, joint venture operations, and debt security arrangements. Other businesses are operated through a trust or estate by operation of law, as in the case of a deceased proprietor.

The advent of the goods and services tax (GST)[3] has introduced an entirely new dimension into the often complex issues involving the taxation of trusts. This new dimension creates many uncertainties because the ETA deals with trusts in a very superficial manner. Unfortunately, there is not yet an extensive body of administrative interpretations or jurisprudence relating to the GST trust provisions, and there appears to be little assistance to be derived from foreign jurisdictions in this regard.

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[1] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA").

[2] For example, the 1987 amendments to the ITA effectively denied access by commercial trusts to the income interest and roll-out rules. For further detail, see Mickey M. Yaksich, "Commercial Trusts Revisited," in *Report of Proceedings of the Forty-First Tax Conference*, 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990), 22:1-14.

[3] Part IX of the Excise Tax Act, RSC 1985, c. E-15, as amended (herein referred to as "the ETA"). Unless otherwise stated, statutory references in this article are to the ETA.

Business Trust Versus Commercial Trust

This article provides a basic overview of how trusts used for business purposes fit into the framework of the ETA. The article also raises a number of GST issues involving such trusts and potential solutions.

A trust connected with the carrying on of business activity will be referred to throughout as a "business trust." The issues examined arise for both inter vivos trusts and estates/testamentary trusts (that is, where a business operation falls into a deceased's estate).[4] Accordingly, our analysis addresses both forms of trust.

The term "commercial trust" is not a technical term of art but is commonly used for income tax purposes to describe a trust that is not a "personal trust."[5] The ITA defines "personal trust" to mean both a testamentary trust and an inter vivos trust in respect of which no beneficial interest was acquired for consideration. Our analysis will focus on both personal trusts and commercial trusts to the extent that they are used to carry on or facilitate business or commercial activities.

FRAMEWORK FOR ANALYSIS

Legal Relationships

A meaningful analysis of the application of GST to trusts must commence with an understanding of the law of trusts generally, including an appreciation of the distinction between trusts and estates. In determining the application of the ETA to a particular circumstance involving a trust or estate, the analysis should begin with an examination of the private law (that is, the common law and various statutes, other than the ETA and ITA, which define the relevant legal relationships).[6] This reference to the private law is important, notwithstanding the difficulties and uncertainties that accompany the analysis, because the ETA does not define the relevant concepts but rather presupposes the rules of equity and, where applicable, the rules of common law, civil law, and various statutes.

The importance of understanding the underlying legal concepts and the distinctions between a trust (or estate) and those persons who are responsible for administering the structure (that is, trustees and personal representatives) cannot be overstated. Failure to appreciate the legal relations imposed by operation of law may result in an inappropriate application of, inter alia, the ETA.

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4 An "inter vivos" trust is literally a trust "between the living." In contrast, a testamentary trust generally arises from a deceased's will.

5 "Personal trust" is defined in subsection 248(1) of the ITA.

6 See D.W.M. Waters, *Law of Trusts in Canada*, 2d ed. (Toronto: Carswell, 1984); and Lloyd F. Raphael, *Canadian Income Taxation of Trusts*, 2d ed. (Don Mills, Ont.: CCH Canadian, 1982). See also Maurice C. Cullity, "General Concepts and Types of Trusts for Tax Purposes," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 36:1-27.

Despite the practical importance of the GST treatment of trusts and the complexity of the potential GST issues, the ETA contains only three sections that directly address GST implications of trusts,[7] and one of these deals exclusively with executors. Inevitably, tax practitioners are left to grapple with GST trust issues largely by reference to statements of administrative policy issued by the Department of National Revenue, Customs, Excise and Taxation.[8] Where the department has not filled the gap, analogies to policies and jurisprudence developed under the ITA typically have been applied by practitioners who are attempting to interpret and comply with the legislation. To assist our analysis and the application of the ETA to a particular relationship, we will refer throughout this article to components of the diagram presented in figure 1.

Legislative Gaps

Figure 1 highlights deficiencies and outright gaps in the application of the ETA to transactions involving trusts and estates. Experience suggests that these flaws are being glossed over by practitioners. It also appears that the department is unaware of these gaps in the legislative framework.

Supplies are frequently made by an estate to a testamentary trust or directly to a beneficiary, as indicated by the line of dashes in figure 1. However, no specific provision of the ETA governs such supplies. As a result, the general rules in the ETA could apply, although the manner in which they should be applied is uncertain. As outlined in detail below, the GST implications of any such supplies could be radically different depending on the private law characterization of a given relationship and depending on whether the supply is arm's length or non-arm's-length. Accordingly, the legislation as it stands contains a significant trap for the unwary.

Two-Step Analysis

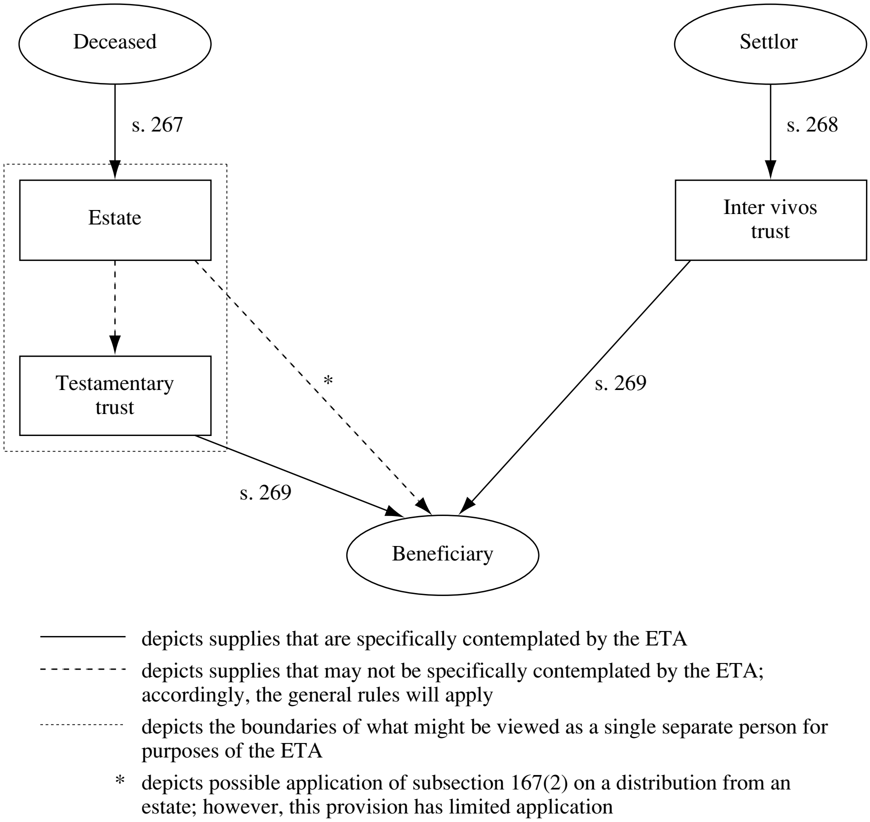
An analysis of the effect of the GST on business trusts must consist of two steps. The first step is to determine the appropriate characterization of the relevant relationship under private law principles. The second step involves the application of specific GST rules to that relationship. This latter step requires an appreciation of three distinct phases in the existence of a trust. These three phases are

1) establishing (that is, creating) the trust or contributing property to the trust;

[7] Sections 267 through 269. Other provisions of the ETA that may have some effect on trusts or estates include subsection 167(2), dealing with a supply of business assets of a deceased; section 270, dealing with clearance certificates; and section 9 of part I of schedule V, dealing with a sale of real property by a trust all the beneficiaries of which are individuals (or contingent beneficiary charities).

[8] Herein referred to as "the department" or "Revenue Canada."

Figure 1



2) carrying on business through the trust; and
3) making distributions of property from the trust.

Relevant ETA Provisions

For purposes of reviewing the GST implications of business trusts, the provisions of the ETA that are particularly relevant are subsection 123(1) and sections 267, 268, and 269. The broad content of these provisions as applied to trusts is briefly outlined below.

Subsection 123(1): Definitions

"Person" is defined in subsection 123(1) to mean "an individual, partnership, corporation, *trust or estate*, or a body that is a society, union, club, association, commission or other organization of any kind [emphasis added]." It is not entirely clear from this definition whether "trust" and "estate" are to be treated as separate conceptions of "person" or whether the wording "trust or estate," without a comma between the two words, indicates that a trust and an estate are to be treated as a single concept.

Despite initial confusion, the department now appears to accept that an estate may be considered a trust.[9]

"Individual" is defined to mean a natural person; that is, it does not include a trust.

The definition of "commercial activity" does not include a business carried on or an adventure in the nature of trade engaged in (other than a supply of real property) by an *individual* if there is no reasonable expectation of profit. For all persons other than individuals, including trusts, there is no requirement that the business be carried on or the adventure be engaged in with a reasonable expectation of profit.

"Business" is defined to include

> a profession, calling, trade, manufacture or undertaking of any kind whatever, whether the activity or undertaking is engaged in for profit, and any activity engaged in on a regular or continuous basis that involves the supply of property by way of lease, licence or similar arrangement, but does not include an office or employment.

"Financial instrument" includes an interest in a trust or any right in respect of such an interest. Since this definition does not refer specifically to an interest in an estate, it is not clear whether transactions involving an interest in an estate would be treated as exempt supplies or be considered subject to tax.

Section 267: Personal Representatives

Section 267 applies on the death of an individual to deem the passing of property to the executor to be a supply for nil consideration and to deem the executor to step into the shoes of the deceased in terms of use of the property, commercial activity status, registrant status, previous payment of tax, and claims of input tax credits.

Section 268: Inter Vivos Trust

Section 268 deals only with the settlement of an inter vivos trust. It deems the settlement to be a supply by way of sale and purchase for consideration equal to the amount determined under the ITA. The settlement of an inter vivos trust thus may carry GST consequences. Specifically, the settlor (or the trust if the reverse collection mechanism applies as provided for in subsection 221(2)) may be liable to collect and remit GST on the value of most taxable supplies.

Section 269: Distribution by Trust

Section 269 deems a distribution of trust property to the beneficiaries to be a supply for consideration equal to the amount determined under the

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[9] Revenue Canada, Excise Information System, Q & A Database [database online], 2E, Q.167, May 1991, initially implied that an estate is not a trust, but the answer was revised in September 1993. See also 2E, Q.291 and 5A, Q.134. These responses clarify that section 9 of part I of schedule V also applies to an estate. For income tax purposes, an estate is expressly included in the definition of "testamentary trust" in section 108 of the ITA.

ITA. There is no distinction for this purpose between inter vivos trusts and other trusts. In contrast to the deeming rule in section 268, a distribution of property by a trust is not deemed to be a supply by way of sale. The significance of this difference is discussed below.

BASIC LEGAL CONSIDERATIONS

What Is a Trust or Estate?

As stated earlier, the starting point for analysis of the GST provisions applicable to a trust or estate is to determine what constitutes a "trust" or "estate" for GST purposes. Since neither the ETA nor the ITA provides any comprehensive definitions, reference must be made to the relevant private law. There are, however, conceptual differences between the common law and the civil law of Quebec. Consequently, the application of the GST provisions may differ for similar transactions depending on whether they are governed by common law or by Quebec civil law.

Trust: A Relationship

A "trust" has been defined as follows:

> [A] fiduciary relation with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.[10]
>
> A confidence which rests either expressly or impliedly in someone (the trustee) for the benefit of someone else (the beneficiary or cestui que trust). In its simplest form, a relation between two people by which the trustee holds property for the cestui que trust's benefit.[11]
>
> A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property), for the benefit of persons (who are called the beneficiaries or *cestuis que trust*), of whom he may himself be one, and any one of whom may enforce the obligation.[12]

A fundamental characteristic of the trust relationship is that the trustee bears a duty and obligation of management of the trust property exclusively for the benefit of the beneficiaries. The trustee has the right to manage trust property, while the beneficiary has the right to enjoy the benefits derived from that property.

The concept of a trust thus refers to a relationship from which certain rights and obligations arise. The trust is not a legal entity[13] separate and

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[10] *Black's Law Dictionary*, 8th ed.

[11] Daphne A. Dukelow and Betsy Nuse, *The Dictionary of Canadian Law* (Scarborough, Ont.: Carswell, 1991).

[12] *Smith v. The Queen*, 87 DTC 5355, at 5360 (FCTD), quoting C. Montgomery White and M.M. Wells, *Underhill's Law Relating to Trusts and Trustees*, 11th ed. (London: Butterworths, 1959), 3.

[13] See *Kingsdale Securities Co. Ltd. v. MNR*, 74 DTC 6674, at 6681 (FCA).

apart from its trustees and beneficiaries, but merely a label for a circumstance in which the law of equity will imply requirements for the holder of property to deal with it for the benefit of another. The ETA, however, establishes a statutory fiction that treats the trust as a separate "person" with no reference to the trustee. The ITA establishes a similar fiction whereby a trust is deemed to be, in respect of the trust property, an individual,[14] but also provides that a reference to a trust is a reference to the trustee.[15]

Estate: A Property Concept

An "estate" has been defined as follows:

> The total property of whatever kind that is owned by a decedent prior to the distribution of that property in accordance with the terms of a will, or, when there is no will, by the laws of inheritance in the state of domicile of the decedent. . . . [The] term includes property of a decedent, trust or other person as such property exists from time to time during the administration, and hence may include probate assets as well as property passing by intestacy.[16]

> All the property of which a testator or an intestate had power to dispose by will, otherwise than by virtue of a special power of appointment, less the amount of funeral, testamentary and administration expenses, debts and liabilities, and succession duties payable out of the estate on death.[17]

The concept of an estate refers to the property owned by the decedent and does not appear to include a reference to the relationship between the executors and the beneficiaries. An estate may therefore include property that may be subject to a testamentary trust.

Trusts and Estates: Comparing the Concepts

The above definitions indicate that an estate is a property concept while a trust is a relationship. A fundamental question is whether the two concepts are treated as one for GST purposes.

An executor or administrator may act in two capacities, as an administrator of a decedent's property and as trustee of property on behalf of beneficiaries. These capacities, arising as they do from separate legal concepts, also are distinct. The distinction is described by Cullity as follows:

> Although for the purpose of certain statutes there has been a tendency to assimilate the position of an executor or other personal representative to that of a trustee, the functions of trustees and personal representatives are

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[14] Subsection 104(2) of the ITA.

[15] Subsection 104(1) of the ITA.

[16] *Black's Law Dictionary*, supra footnote 10. See also *In re McKenna Estate*, 51 DTC 533, at 534 (NB SC), where the court adopted the following meaning of estate: "[t]he collective assets and liabilities of a person (especially of a deceased person)."

[17] *The Dictionary of Canadian Law*, supra footnote 11.

> generally quite distinct, and a significant amount of confusion can be created if, apart from such statutes, personal representatives are regarded as holding the assets of the estate as trustees. Trustees are concerned with the custody and management of assets for the benefit of the beneficiaries of the trust; in contrast, the primary responsibility of personal representatives is to wind up the estate of a deceased person by collecting his or her property and discharging all claims against it.[18]

This distinction raises difficulty and uncertainty with respect to the application of the GST provisions to trusts and estates.

There is, however, significant overlap between the status of executor and trustee. It has been observed that "the Courts have not distinguished between . . . executors, and trustees, but they have put them all together and considered that they are liable under the same principles."[19] The Ontario Trustee Act[20] considers the words "trust" and "trustee" to include an executor or administrator of an estate. The ETA treats an estate as a person, with no reference to the executor/administrator, while the ITA treats an estate in the same manner as a trust.[21] The equivalency of treatment under the ITA is based on express statutory provisions to that effect, whereas the ETA does not contain similar provisions and does not specifically address whether an estate and a trust are to be treated as one concept for GST purposes.

A further possible distinction between a trust and an estate relates to the identity of the owners of the legal and beneficial interests in the property. The very nature of a trust is that the trustee owns the legal interest in the property, while the beneficiaries own the beneficial interest. In the case of an estate, it seems clear that this holds true for specific bequests of property (whether or not there is sufficient residue to pay all debts), but there is a debate among the authorities as to whether the executor holds the entire legal and beneficial interest in property falling into the residue of the estate until the estate has been administered.[22] This point raises further difficulty with respect to the application of the GST rules: if there are actually two changes in the beneficial ownership of

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[18] Cullity, supra footnote 6, at 36:2.

[19] *In re Speight* (1883), 22 Ch. D. 727, at 742 (CA).

[20] RSO 1990, c. T.23, as amended, section 1.

[21] Subsections 104(1) and (2) of the ITA.

[22] Cullity, supra footnote 6, at 36:3, suggests that the executor holds legal and beneficial ownership, citing *Re Neeld*, [1962] 2 All ER 335, at 359 (CA); *In Re Steed and Raeburn Estates*, 49 DTC 580 (SCC); *Comr. of Stamp Duties (Q'd.) v. Livingston*, [1965] AC 694 (PC); and *Lord Sudely v. Attorney-General*, [1897] AC 11 (HL). In *The Queen v. Boger Estate*, 93 DTC 5276, however, the Federal Court of Appeal accepted that under Alberta law, the beneficial interest in property subject to a will and not subject to a specified bequest is "transferred" and may be "vested indefeasibly" as at the date of death, notwithstanding that the property was part of the residue of the estate. See also the three separate views expressed by the Federal Court of Appeal judges regarding this issue under Saskatchewan law in *Hillis et al. v. The Queen*, 83 DTC 5365.

estate property (from the deceased to the estate/executor and then to the beneficiary), are there also two separate potential incidences of GST?

A trust is not limited to those situations in which it arises expressly; it also may come into existence by implication or by operation of law. For example, a constructive trust may arise by implication in circumstances where one party has been unjustly enriched at the expense of another.[23] The courts may impose the constructive trust as a restitutory remedy based on principles of fairness and equity.[24] A resulting trust may arise when the law imposes on the holder of legal or equitable title to property who did not give value for the property, an obligation to return the property to its original owner or to the person who did give value for it.[25] In these situations, intention plays no part in the creation of the trust. As a result, GST rules relevant to trusts could technically apply without any recognition by the parties that a trust exists.

A "trust" at common law is thus a rather ethereal concept, and it may be difficult to determine whether a trust exists in a given fact situation. Nevertheless, the exercise is essential for the purpose of determining GST consequences. Determining whether an estate exists is somewhat easier; however, the overlap between an estate and a trust is complicated. One must exercise considerable care in evaluating whether the trust and/or estate rules in the ETA may be applicable to a given transaction. The first step in addressing potential GST consequences is to determine the true legal nature of the particular arrangement.

Essential Elements of a Trust

The fundamental requirements of an express trust have been described as "the three certainties": certainty of intention, certainty of subject matter, and certainty of objects.[26] If it is desirable to have the ETA trust provisions apply to, for example, a settlement of an inter vivos trust, it is essential that a properly constituted trust be brought into existence.

Certainty of intention requires some clear manifestation of an intention on the part of the settlor to establish the trust. However, no technical requirements are imposed, and the intention may arise by way of oral declaration[27] or may be inferred from conduct. Nevertheless, the language used must be sufficient to indicate that the present creation of a trust was intended rather than some vague wish or future expectation.

Certainty of subject matter requires that the property that is to be subject to the trust be identified and that the interests of the trust benefi-

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23 See, for example, the line of cases commencing with *Pettkus v. Becker*, [1980] 2 SCR 834.

24 Waters, supra footnote 6, at 377-427.

25 Ibid., at 299.

26 Ibid., at 107-28.

27 Subject to certain statutory rules that limit the enforceability of contracts respecting real property unless the intention is reflected in writing.

ciaries be clearly defined. If the description of trust property is too vague to be enforced, the trust will fail.

Finally, certainty of objects requires that the persons to benefit from the trust or the purposes of the trust must be capable of being ascertained. If the beneficiaries of the trust are a class of persons, it must be possible to determine whether or not a person is a member of that class and the totality of the membership of that class. For example, a trust in favour of the testatrix's "close friends" was found to fail on this test.[28] Most "purpose trusts" are considered void unless they are for a charitable purpose,[29] but once a charitable purpose is identified, the courts grant considerable leeway in examining certainty of that purpose.

Once the three certainties are established, the only further technical requirement for a valid express trust is that the trust property vest in the trustee.[30] The nature of the trust relationship thus involves "split ownership": the trustee holds the legal title to, or interest in, the trust property, while the beneficiaries hold the beneficial interest in the property.

The Bare Trust

One particular type of business trust commonly encountered in practice is the bare trust. Bare trusts may be used for a variety of purposes:

- to avoid property purchase tax, by arranging for a change in beneficiaries to take place on a sale of the real property without a change in the "trustee" registered owner, usually a nominee corporation;
- to facilitate commercial transactions involving multiple steps and transfers of ownership;
- to facilitate ongoing commercial enterprises—for example, where a nominee corporation holds title to property that is dedicated for use in a joint venture; or
- to hold security on behalf of debenture holders.

The label "bare trust" may be applied to a variety of relationships bearing certain trust characteristics, but it is generally understood to mean a relationship where the trustees "hold property without any further duty to perform except to convey it to the beneficiary or beneficiaries upon demand" or as directed by the beneficiaries.[31] The trustee fulfils a passive role and is under the control of the beneficiary. The absence of any active duties on the part of the trustee raises the question whether a bare trust should be treated as a true trust for tax purposes, or rather as a simple agency relationship. A bare trust may not be a trust at all.

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[28] *Re Connor Estate* (1970), 72 WWR 388 (Alta. CA).

[29] See *LIUNA Local 527 Members' Training Trust Fund v. The Queen*, 92 DTC 2365 (TCC).

[30] Waters, supra footnote 6, at 129.

[31] Ibid., at 27.

A relationship of agency is defined as follows:

> [The r]elation in which one person acts for or represents another by latter's authority. . . . The relation created by express or implied contract or by law, whereby one party delegates the transaction of some lawful business with more or less discretionary power to another. . . . The consensual relation existing between two persons, by virtue of which one is subject to other's control.[32]

Agency is based on contractual principles, while a trust relationship is based primarily on equitable principles. Further, an agent acts on behalf, and under the control, of the principal, while a trustee generally has independence and discretion.

A debate has existed in recent years over the proper characterization of bare trusts, as different scholars have attempted to draw a line between trust and agency on different bases. The United States has developed a test to distinguish between trust and agency on the basis of ultimate control of trust property, but it is not entirely clear whether such a control test is part of English and Canadian common law.[33] Some Canadian courts have adopted the control test, stating that relationships of trust and agency may be distinguished on the basis of control by the principal/beneficiary over the actions of the agent/trustee.[34] A principal has control over an agent and may delineate the limits of the agent's authority to bind the principal, while a trustee takes direction from the trust deed and is not subject to the wishes of the beneficiaries. Another basic point of legal distinction is that an agent does not generally take title to the principal's property, while the very nature of a trust requires the trustee to be vested with legal title to property, the beneficial interest of which is vested in the beneficiaries. The law, however, recognizes circumstances in which an agent takes title to a principal's property such that relationships of agency and trust may coexist.[35]

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[32] *Black's Law Dictionary*, supra footnote 10.

[33] The opposing positions are expressed in Robert D.M. Flannigan, "Beneficiary Liability in Business Trusts" (February 1984), 6 *Estates and Trusts Quarterly* 278-304; Maurice C. Cullity, "Liability of Beneficiaries—A Rejoinder" (March 1985), 7 *Estates and Trusts Quarterly* 35-52; R.D.M. Flannigan, "The Control Test of Principal Status Applied to Business Trusts" (September 1986), 8 *Estates and Trusts Quarterly* 37-129; and Maurice C. Cullity, "Liability of Beneficiaries—A Further Rejoinder to Mr. Flannigan" (September 1986), 8 *Estates and Trusts Quarterly* 130-41.

[34] See *Fraser v. The Queen*, 91 DTC 5123 (FCTD), and *Powell v. MNR*, 78 DTC 1259 (TRB), rev'd. 80 DTC 6301 (FCTD). In *The Queen v. Placer Dome Inc.*, 92 DTC 6402, at 6410, the Federal Court of Appeal suggested that an alleged trustee of a stock purchase plan was a mere agent or servant on the basis that it had no independent discretion or autonomous power.

[35] In *Trident Holdings Ltd. v. Danand Investments Ltd.* (1988), 49 DLR (4th) 1, at 13, the Ontario Court of Appeal recognized that a person may be both agent of and trustee for another. The court held that where the agent/trustee was not exercising any power or discretion conferred by the trust and was under the control of the beneficiaries, the agency aspect of the relationship dominated over the trust aspect. See also *Berlin v. MNR*, 74 DTC 1185 (TRB).

Other writers have suggested that in making the characterization, the question of the trustee's duties and powers is not as important as the intention of the settlor, as determined by full consideration of all relevant circumstances.[36] Still others have argued that where there is both an element of trust and an element of agency in the relationship, even if the trustee/agent is under fiduciary duties, where the *primary* role of the trustee/agent is to discharge its obligations under a contractual agreement with the settlor, the agency relationship should be considered to displace the trust relationship for income tax purposes.[37] In any event, it appears that the debate has not been finally resolved, and there remains significant uncertainty as to the proper legal characterization of a bare trust.

The importance of the question of characterization for tax purposes cannot be overstated. If a bare trust constitutes a mere agency relationship, any activities of the trust will automatically flow through to the trust beneficiaries (subject to the application of section 177 for ETA purposes). If, on the other hand, the bare trust is construed as a true trust for tax purposes, the entire machinery of sections 104 to 108 of the ITA comes into operation since the trust is considered a separate person for income tax purposes, and all of the complicated rules governing the trustee/beneficiary relationship will apply. Similar complications arise under the ETA, since a trust is treated as a separate person for GST purposes.

The department's policies in regard to bare trusts will be discussed later in this article.

TRUSTS AND ESTATES IN THE OVERALL SCHEME OF THE ETA

The ETA provides no basis for distinguishing between the legal and equitable interests in property. The failure to draw this distinction makes for uncertainty and inconsistency, and even raises the spectre of cascading GST (or double taxation) in certain trust circumstances.[38]

Perhaps the most fundamental feature of the treatment of trusts and estates for GST purposes is that a trust and an estate are included in the definition of "person" in subsection 123(1). The artificial concept that a trust or an estate is a separate taxable entity is applied in the ETA, similar to the scheme of the ITA.[39] Rather than taxing beneficiaries directly on

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36 Donovan W.M. Waters, "An Overview of the Law of Trusts," in the 1988 Conference Report, supra footnote 6, 35:1-28, at 35:9.

37 Douglas S. Ewens, Rosemarie Wertschek, and James R. Wilson, "Income Tax Implications of Utilizing Bare Trusts," The Taxation of Corporate Reorganizations feature (1989), vol. 37, no. 2 *Canadian Tax Journal* 499-516.

38 See the discussion on the topic of double taxation in Dalton J. Albrecht, "The GST in Relation to Trusts and Estates," in *Report of Proceedings of the Forty-Third Tax Conference*, 1991 Conference Report (Toronto: Canadian Tax Foundation, 1992), 39:1-25, at 39:9.

39 As noted earlier, subsection 104(2) of the ITA deems a trust (and an estate) to be an individual for purposes of the ITA. The ETA does not deem a trust or an estate to be an individual.

the basis of their beneficial interest in trust or estate property, Parliament has chosen to impose tax at the trust level. This choice has led to considerable complexity in the ITA. Many provisions have been enacted in an attempt to preserve the integrity of trust/estate and beneficiary taxation, while recognizing that the trust/estate is a conduit to the beneficiaries. The ETA, on the other hand, contains only a few basic rules and leaves a number of important questions unanswered.[40]

The statutory scheme of the ETA is deceptively simple. The interaction of these relatively straightforward rules with the remainder of the ETA creates significant complexity and uncertainty.

GST CONSEQUENCES ON ESTABLISHING THE ESTATE OR TRUST

Supply

Estate/Testamentary Trust

The ETA appears to draw a distinction between an estate (and perhaps a testamentary trust) on the one hand and an inter vivos trust on the other, with respect to the GST consequences in each case.[41] Section 267 sets out five specific rules that apply when an individual dies:

1) The passing of property of the deceased to the executor is deemed to be a supply of the property made for no consideration.

2) For GST purposes in respect of property of the deceased that became vested in the executor, the executor is deemed to have paid any GST paid by the deceased in respect of the property and to have claimed any input tax credit claimed by the deceased in respect of the property.

3) The executor is deemed to use the property of the deceased immediately after the death in the same way and for the same purposes as the deceased used the property immediately before that time.

4) Where immediately before the death the deceased was engaged in a commercial activity, the executor is deemed to be engaged in that activity immediately after the death.

5) Where immediately before the death the deceased was a registrant, the executor is deemed to be a registrant immediately after the death.

As a result, no GST consequences should arise on the death of an individual. The executor should effectively step into the shoes of the deceased

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[40] The ETA also contains some notable exceptions from the GST principles applicable to trusts. For example, the administrator of a bankrupt is often referred to as a "trustee," but section 265 deems a trustee in bankruptcy to be an agent of the bankrupt and deems the estate of the bankrupt not to be a trust or estate. The property of the bankrupt is deemed not to pass to and be vested in the trustee in bankruptcy. Section 266 has a similar effect for a receiver appointed to manage, operate, or liquidate any business or property, or to manage the affairs, of a person.

[41] For a perspective on the application of the ETA to trusts and estates, see Albrecht, supra footnote 38, and Peter Wong, "The Goods and Services Tax and Wills, Trusts and Estates" (December 1991), 11 *Estates and Trusts Journal* 113-33.

in terms of eligibility to claim input tax credits, the use to which the property is put, commercial activity status, and registrant status. Whether this is also the result where one or more testamentary trusts are created under the terms of the will is less certain. Figure 2 (which parallels a segment of figure 1) highlights some of the technical concerns.

If section 267 was intended to be a "complete code" applicable on the death of a person, presumably the results that flow from the application of that section should address both the vesting of property in the executor and, where there has been a specific bequest, the vesting of the beneficial interest in property in the beneficiary. On the other hand, if section 267 applies only to the executor, perhaps the general rules in the ETA could apply to impose GST consequences in the event of a specific bequest when there is a passing to the beneficiary of the beneficial interest in property. The same issue arises when the subject property passes to a testamentary trust for the benefit of a particular person, rather than directly to that person. The key issue in these circumstances is whether the estate and the testamentary trust are to be regarded as the same entity, or as separate entities, for GST purposes.

Under the private law, the concepts of testamentary trust and estate are distinct. A testamentary trust of the residue of an estate may come into existence only on completion of the administration of the estate.[42] This distinction at law lends support to the view that an estate and a testamentary trust should be treated as distinct persons for GST purposes.

The language of section 267 gives rise to a number of interpretive uncertainties in this regard. Section 267 refers to the passing of property of the deceased to the executor, and its deeming provisions operate upon the executor. There is no reference to "estate" in subsection 267(1), yet it is the estate that is deemed to be a separate person for GST purposes pursuant to the definition of "person."[43] In addition, unlike the ITA, the ETA contains no provision deeming a reference to a trust or an estate to be read as a reference to a trustee or an executor,[44] or vice versa.

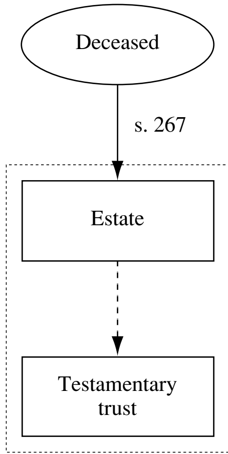
Section 267 may be contrasted to sections 268 and 269 in this regard, since the deeming provisions of the latter sections operate upon the trust and not the trustee. As there is no rule in the ETA that would deem the executor to be the taxpayer rather than the estate, an argument could be advanced that the deeming rules in section 267 are inoperative on the establishment of an estate. The department would be most unlikely to

[42] Maurice C. Cullity, "Trusts and Estates," in Brian G. Hansen, Vern Krishna, and James A. Rendall, eds., *Canadian Taxation* (Don Mills, Ont.: De Boo, 1981), 773-822, at 776-77.

[43] Subsection 123(1). See the discussion above under the heading "Subsection 123(1): Definitions."

[44] As is the case in subsection 104(1) of the ITA. The department has stated that "executor" or "trustee" may be interpreted to mean "person," but it is not clear how the status of an executor or a trustee as a person interacts with the status of the trust or estate as a person.

Figure 2



———— depicts supplies that are specifically contemplated by the ETA

- - - - - - - depicts supplies that may not be specifically contemplated by the ETA; accordingly, the general rules will apply

·············· depicts the boundaries of what might be viewed as a single separate person for purposes of the ETA

apply the rule in this manner, since section 267 would be meaningless in such circumstances, but the legislative gap nevertheless exists.

The most reasonable interpretation of the legislation is that the estate and the executor should be considered the same "person" for GST purposes. The estate owns the property and makes the supplies, and the executor simply administers the estate, rendering services. Accordingly, the deeming provisions of section 267 would apply to the estate and not merely the executor as a separate person.

This appears to have been the intention behind section 267, since the technical notes seem to use the words "estate" and "executor" interchangeably, and state that "no GST applies on the transfer of property to an individual's estate."[45] (This is the basis for the solid line between "Deceased" and "Estate" in figure 2.) Although this interpretation may produce a reasonable result, it requires a rather tortured reading of the words in section 267. Legislative reform to clarify this matter is desirable.

A second concern is the distinction that the ETA appears to draw between the notion of a trust and an estate. The definition of "person"

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[45] Canada, Department of Finance, *Goods and Services Tax: Explanatory Notes to Bill C-62 As Passed by the House of Commons on April 10, 1990* (Ottawa: the department, May 1990), 134.

appears to refer to a trust and an estate separately,[46] although, as noted earlier, the absence of a comma after "trust" in the phrase "trust or estate" could indicate a legislative intention to treat a trust and an estate as a single concept. Given the style of drafting for other definitions in section 123, however, the better view is that a trust and an estate constitute separate persons for GST purposes. It also seems unwise to read too much into the absence of a comma in this case, since the basic legal concepts of a trust and an estate differ markedly,[47] and other comparable statutes, such as the ITA, *expressly* combine the two concepts into one.

In circumstances where the will of a deceased creates a certain type of testamentary trust, section 267 applies when the estate vests in the executor, but it does not appear to apply, on its technical wording, to the vesting of property of the estate in a testamentary trust, considered separately from the estate. Since the ETA appears to regard trusts and estates as separate concepts, the correct technical treatment is uncertain. (This is the basis for the dashes between "Estate" and "Testamentary trust" in figure 2.)

If section 267 applies to the creation of an estate, can its wording be stretched to apply to the creation of a testamentary trust? In other words, are the estate and the testamentary trust illustrated in figure 2 the same entity for GST purposes? If the executor is fulfilling the function of both executor and trustee, as is often the case, there may be a good argument to this effect; but what if the executor and the trustee are not the same person, or if the legislation contemplates a supply from a person in his or her capacity as "executor" to himself or herself in the capacity of "trustee"? Section 267 does not expressly have any application to the trustee or the trust. Since section 268 applies only to inter vivos trusts, there is no specific deeming rule that would apply to the establishment of a testamentary trust.

The broad wording of the definition of "executor" in subsection 267(2) could arguably be stretched to include the trustee of a testamentary trust (as a person who is responsible for administration of the property of the deceased individual). It also could be argued that the legislators were unlikely to have left a gap in the legislation, so that the limitation of section 268 to inter vivos trusts by implication supports the position that section 267 must apply to testamentary trusts.

The issue we are concerned with here is whether, in the absence of a deeming provision, the establishment of a testamentary trust on the death of a decedent constitutes a supply. It may be argued that this concern is unfounded because no adverse GST consequences can arise when no consideration is payable, even if the establishment of a testamentary trust

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46 Subsection 123(1). See the discussion above under the heading "Subsection 123(1): Definitions."

47 See the discussion above under the heading "What Is a Trust or Estate?"

constitutes a supply. However, this argument is displaced if the supply is not at arm's length. In such circumstances, section 155 could apply and deem consideration to have been paid.[48] This possibility is another trap that many practitioners may be unaware of.

Further uncertainty arises regarding the interpretation of section 267 because of the use of the words "immediately after [the death]." The executor is deemed, immediately after the death, to use the property, to be engaged in a commercial activity, and to be a registrant in a manner that is consistent with the status immediately before the death. There is no guidance in the legislation, however, as to whether this deeming rule is indefinite. For example, when will the change-of-use rules apply if the executor, or the trustee of a testamentary trust, uses the property of the deceased for a different purpose than that of the deceased? If the deceased used the property primarily in a commercial activity but the executor never does so, it is not entirely clear how the deeming provision in section 267 interacts with the change-of-use provisions. Presumably, section 267 is intended only to ensure that the death itself will not cause the change-of-use rules to apply (simply because of an interruption in use of the property), but it would not override the change-of-use rules once the executor in fact commenced a different use.

Inter Vivos Trust

An inter vivos trust for GST purposes has the same meaning as that in paragraph 108(1)(f) of the ITA: it is a trust other than a testamentary trust.[49] Subsection 108(1) of the ITA defines a testamentary trust as a trust *or estate* arising on and in consequence of the death of an individual.

The GST consequences of the establishment of an inter vivos trust are set out in section 268, which deems the settlement of property on an inter vivos trust to be a supply by way of sale and purchase of that property for consideration equal to the proceeds of disposition as determined under the ITA. The GST provisions seem to apply in a reasonable manner to supplies made to an inter vivos trust. Generally, a person contributing to an inter vivos trust should be concerned with two issues: the nature of the supply and the deemed consideration in respect of the supply.

The uncertainties that arise in respect of the nature of the supply concern the possibility that a testamentary trust may be retroactively recharacterized as an inter vivos trust. Under paragraphs (b) and (c) of the definition of "testamentary trust" in subsection 108(1) of the ITA, a testamentary trust may lose its status and be considered an inter vivos trust for income tax purposes, and therefore GST purposes, if property is

[48] See the discussion of this issue in Thomas B. Akin, Maurice Arsenault, Irene J. David, and W. Jack Millar, "GST Round Table," in *Report of Proceedings of the Forty-Fifth Tax Conference*, 1993 Conference Report (Toronto: Canadian Tax Foundation, 1994), 57:1-44, question 40, at 57:42-43.

[49] Section 268.

contributed to the trust otherwise than by an individual on or after his death and as a consequence thereof.

For GST purposes, the status of the trust as inter vivos should matter only at the time of settlement. Nevertheless, the ITA definition appears to retroactively negate testamentary trust status in a taxation year if property is contributed to the trust at any time before the end of the relevant taxation year by a person other than the deceased (otherwise than by an individual on or after his death and as a consequence of the death). In the unusual situation where a third party contributes property to what would otherwise be a testamentary trust of a person on that person's death, and does so within the first taxation year of the trust, the trust will be considered an inter vivos trust for GST purposes, and it appears that section 268 would apply to that settlement of property.

With respect to the nature of the supply, the meaning of "settles" or "settlement" is relevant. The word "settles" in section 268 is a term of very broad scope, such that a transfer of legal title to the property is not necessary and a simple declaration of trust will be caught.[50] A "settlement" generally conveys the idea of a gift or provision made for a trust,[51] and involves a disposition of property by a settlor for the benefit of a person on whose behalf the settlement is made with the contemplation that the property be retained, its use and enjoyment being determined by the terms of the settlement.[52] It therefore appears that a settlement would not include a sale of property to a trust for fair market value, but would include any gratuitous transfer of property to a trust, including one that took place after the initial settlement of the trust.

Section 268 adopts the ITA interpretation of proceeds of disposition to the settlor; namely, such proceeds generally will be the fair market value of the property,[53] subject to the rollover rules in the ITA, which may deem the proceeds to be a lesser amount. In particular, subsection 73(1) of the ITA permits a transfer of capital property to occur on a tax-deferred basis (that is, the income tax is deferred) if the property is transferred by a taxpayer to a trust under which the taxpayer's spouse is entitled to all of the income of the trust and no person other than the spouse may receive any benefit under the trust during the spouse's lifetime. Subsection 70(6) of the ITA contains a similar rule for a spousal trust created under a deceased's will. The GST consequences that arise when the latter provision applies are uncertain. Logically, one would assume that the GST rollover provisions in section 267 were intended to apply because it is a

[50] "Settlement" is defined in *The Concise Oxford Dictionary*, 6th ed., as, inter alia, "conveyance of, *or creation of* estate(s) in, property to make provision for one or more beneficiaries [emphasis added]."

[51] See *In re Bozanich*, [1942] SCR 130, per Rinfret J.

[52] See *Re Reddin* (1980), 20 BCLR 188 (SC).

[53] Subsection 69(1) of the ITA.

testamentary matter. However, this result is not clear, for the reasons discussed above.

Section 268 of the ETA deems a settlement to be a supply by way of sale. There is some question whether this deeming provision is necessary, given the very broad definition of "sale" in subsection 123(1) to include any transfer of ownership. It appears that the only distinction between a "supply" and a "supply by way of sale" in the legislation is that the latter concept does not include a licence, rental, or lease of property. Since a settlement of property upon a trust will generally constitute a transfer of legal and/or beneficial ownership, the settlement should be, by definition, a supply by way of sale.

Bare Trust

The department has proven more willing to grapple with the bare trust issue for GST purposes than it has in the income tax context. Perhaps this is not surprising since a bare trust otherwise could be used to avoid GST in a manner similar to the techniques used to avoid property purchase tax (subject to statutory avoidance rules). For example, if a person transferred the subject property to a bare trust, that person (the vendor) could then simply transfer its beneficial interest in the bare trust or its shares in a bare trust corporation (both such supplies being an exempt financial service), rather than the underlying property itself.

In June 1992, the department announced its administrative policy with respect to bare trust arrangements in which the trustee only holds legal title to a property and performs no other functions.[54] It stated that the beneficiary of such a trust will be considered engaged in a business respecting the trust property and that it is the beneficiary, rather than the bare trust, that will be required to register. This policy will not apply, however, if the trustee has any independent powers and responsibilities over the trust property; in that case, the trust will be required to register for GST purposes.

The department further refined its views on bare trusts in *Technical Information Bulletin* B-068, released January 20, 1993. The policy set out in that bulletin was to be considered effective from January 1, 1991. The department now considers a bare trust to exist where the "trustee" is merely vested with the legal title to property and has no other duties, responsibilities, or powers apart from conveying legal title at the direction of the beneficiary. The "trustee" is not in control of the trust property in these circumstances, and the settlor or beneficiary is the person engaged in the commercial activity. The department appears to have adopted the "control" test discussed above under the heading "The Bare Trust." The department bases its position on the distinction between trust and agency, and focuses on the nature of the duties contemplated in the instrument establishing the relationship. The department also takes the view

[54] Revenue Canada, *Excise/GST News*, no. 5, June 1992.

that the transfer of legal title in a property to a trust without the corresponding transfer of the beneficial interest is a transaction having little or no monetary value.

While the department's position as expressed in TIB B-068 is not legally binding, and certain aspects of it are legally controversial, the bulletin at least provides taxpayers and their advisers with some guidance on the likely GST implications of using a bare trust.

For a trust qualifying under the department's conception of a bare trust as discussed above, the deeming rule in section 268 will effectively be ignored, since the transfer of legal title should be viewed as taking place for nominal consideration.[55] If the settlor transfers property to a bare trust to be transferred at the settlor's direction, the department will consider beneficial ownership of the property to remain in the settlor for GST purposes. If, however, the settlor transfers property to a bare trust to be transferred at the direction of a third party, the department will presumably consider a supply of the beneficial ownership to have taken place between the settlor and the third party, because in these circumstances there would have been a shift in beneficial interest in the property to the third party.

Constructive Trust

It is not clear whether any GST implications would arise from the declaration by a court of a constructive trust as a restitutory remedy. It may be argued that a person has not settled an inter vivos trust as required by section 268, but rather a trust has simply arisen by operation of law upon a court declaration; the court has not conveyed or created any interest in property, but is only declaring a state that already exists at law.

Alternatively, it could be argued that the constructive trust is a fiduciary relationship, but not to the extent of creating a trust for tax purposes. However, constructive trusts have been recognized as trusts for purposes of the ITA. The department has stated that it will apply the trust rules of the ITA to a constructive trust and will consider such a trust to have been created at the time the property was acquired by the ultimate constructive trustee, or later, as the circumstances require. The department does not consider the time of the court judgment to be relevant in determining the time at which the trust was created.[56]

If this policy is applied for GST purposes, GST consequences under section 268 would presumably arise at the time the ultimate constructive trustee acquired the interest in the property that is subject to the constructive trust. Considering the typical lengthy time frame for litigation of this nature, this policy may give rise to GST liability plus significant interest and penalties from the time the property vested in the constructive trustee to the time the liability is discharged.

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[55] *Technical Information Bulletin* B-068, "Bare Trusts," January 20, 1993, 6-7.

[56] "Revenue Canada Round Table," in the 1988 Conference Report, supra footnote 6, 53:1-188, question 31, at 53:47. This position appears to be based on the decision in *Fletcher v. MNR*, 87 DTC 624 (TCC).

Character of Supply

Section 268 deems the settlement of an inter vivos trust to be a supply but does not affect the nature of that supply. A settlement upon a trust of property that would otherwise constitute an exempt or zero-rated supply does not cease to be exempt or zero-rated because of the deeming rule in section 268. For example, the settlement of corporate shares or certain used residential complexes upon a trust would remain exempt supplies.

"Taxable supply" is defined in subsection 123(1) to mean a supply that is made in the course of a commercial activity. If the settlement is not made in the course of a commercial activity, the deemed supply will not be a taxable supply. "Commercial activity" generally includes a business, an adventure in the nature of trade, and a supply of real property, other than the making of exempt supplies and activities of individuals undertaken without a reasonable expectation of profit.

An individual who is not engaged in a commercial activity and conveys property to a trust for the purpose of establishing the trust as a business vehicle may not be making a taxable supply. However, former subsection 141(5) deemed any activity in connection with the establishment of a commercial activity to be part of the commercial activity. This wording left open the possibility that the individual may be deemed to be carrying on a commercial activity, despite the fact that he or she is not the person who eventually carries on the commercial activity. Subsection 141.1(3), effective September 30, 1992, replaced subsection 141(5) and eliminated this uncertainty by limiting the deeming rule to activities of a person in connection with the establishment of a commercial activity *of that person*. Consequently, the individual referred to at the beginning of this paragraph need not register or charge GST on the supply.

Since an adventure in the nature of trade is included in the definition of "commercial activity" in subsection 123(1), the supply could become taxable if an individual settlor acquired property with an intention of shortly afterward transferring it to the trust. This rule would apply if an individual settlor had a reasonable expectation of profit in respect of the subsequent transfer, except in the case of a transfer of real property. (Subject to the application of the "exempt supply" rules, the supply of real property should be taxable.) However, since a settlement is generally for no consideration (that is, a gift), there likely would never be a reasonable expectation of profit.

Finally, settlement of money upon a trust is not a supply since money is excluded from the definitions of "property" and "service" for purposes of the ETA.

Exceptions for Taxable Supply

Settlor Is a Small Supplier

Even if the deemed supply on settlement of a trust is a taxable supply, GST is not necessarily payable. If the settlor of the trust is a small supplier within the meaning of section 148 and is not a registrant, and if the property settled upon the trust is not a supply of real property by way of sale, no GST will be payable pursuant to section 166.

All or Substantially All Exception

Section 167 sets out a further exception to liability to pay GST in circumstances where the supply is of a business or part thereof and the recipient is acquiring all or substantially all (interpreted by the department to mean 90 percent or more) of the property reasonably necessary for the recipient to carry on the business or part thereof. The entire supply is generally considered to be free of GST. Section 167 will not apply where the supplier is a registrant and the recipient is not. Registrant status for the trust may therefore be important, as discussed below. Section 167 may be useful where a person or persons are currently carrying on a business and wish to transfer the business or a part of it to a trust, which will continue to carry on the business.

Section 167 has given rise to many difficulties of interpretation and has been significantly modified since its initial enactment. In practical terms, and notwithstanding those amendments, it may be difficult to determine with certainty whether a disposition by a person of a portion of the person's operating assets is a supply of "part of a business." Even though the wording of this section has been altered to shift the focus from "all or substantially all of the property used in a commercial activity that forms all or part of a business" of the vendor to a similar test for the purchaser, there remains a requirement that the vendor dispose of "a business or part of a business."

It may be to the advantage of taxpayers in this situation that "business" is defined very broadly in subsection 123(1) to exclude a profit requirement and that it includes "any activity engaged in on a regular or continuous basis that involves the supply of property by way of lease, licence or similar arrangement." It may be difficult, however, to determine whether the property acquired "can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business or part of a business." The explanatory notes to Bill C-112 indicate that this wording is intended to allow a recipient to acquire a business or part of a business and combine it with an existing business of the recipient. The explanatory notes, however, shed no light on how the phrase "part of a business" is to be interpreted.[57]

The consequences of failing to deal with these issues correctly may be serious, since interest and penalties may be imposed on transactions that mistakenly rely on section 167. In cases of uncertainty, it may be safest to simply have the settlor collect and remit the GST and have the trust claim an offsetting input tax credit (discussed below).

[57] See Revenue Canada, Excise Information System, Q & A Database [database online], 6D, Q.46 for a list of relevant factors. See also draft *Policy Statement* P-188, "Supply of a Business or Part of a Business," October 25, 1995.

Registration of Estate/Trust

An executor, estate, or trust may be required to apply for registration for GST purposes. Under section 240, registration is mandatory for every person making taxable supplies in the course of a commercial activity in Canada, other than a small supplier, a vendor of real property otherwise than in the course of a business, and a non-resident not carrying on business in Canada.

Registration of an Estate

In the case of an estate, paragraph 267(1)(e) deems an executor to be a registrant where the deceased was a registrant. However, the "person" for purposes of the ETA is the estate, and the estate is not expressly deemed to be a registrant. Therefore, as a technical matter, it is not clear whether the estate is required to register if it carries on a commercial activity (that is, whether section 267 applies to the executor but not to the estate). As discussed above, we are of the view that the more reasonable interpretation of section 267 is that its deeming provisions apply to the estate as well as the executor. Even if the executor is equated with the estate, however, it is not clear from the legislation whether the executor must apply for a new registration number or whether the executor may continue to use the registration number of the deceased. The department takes the administrative position that the executor may use the deceased's registration number.[58]

Commercial Activity

The key issue under section 240 of the ETA is whether the trust is engaged in a "commercial activity," which, as noted above, is defined to include any business carried on, any adventure in the nature of trade, and any activity involving the supply of real property. Unlike an individual, a trust need not have a reasonable expectation of profit from a business or an adventure in the nature of trade in order to be considered engaged in a commercial activity. "Business" is defined broadly in subsection 123(1). The body of jurisprudence developed under the ITA with respect to the meaning of "business," "carrying on business," and "adventure in the nature of trade" may be of assistance in interpreting these definitions.

The broad language raises the question whether the actions of an executor in administering and winding up an estate constitute an "undertaking of any kind whatever." Since many executors are not generally engaged in a business enterprise, it appears that the "commercial activity" of an estate may be limited to those activities of the decedent which constituted commercial activities.

[58] Revenue Canada, Excise Information System, Q & A Database [database online], 8A, Q.53.

Registrant Status

If a trust is settled for the purposes of engaging in business or trading activity or in any supply of real property, it is required to be registered (provided that the trust is not a small supplier) once it makes a taxable supply. At that time, it will be considered a registrant under the ETA, whether or not it has in fact become registered, because the term "registrant" is defined in subsection 123(1) to mean a person who is registered *or who is required to be registered* under the ETA.

Subsection 141.1(3) extends the notion of commercial activity to include anything done in connection with the establishment, acquisition, disposition, or termination of a commercial activity. Even if the trust is not yet engaged in ongoing commercial activities at the time it is settled, this deeming rule may cause commercial activities to commence immediately on settlement of the trust. In this event, the trust will be required to register once a taxable supply is made, rather than on some later date.

Exception for Small Suppliers

One important exception to the registration requirement is "small supplier" status. If the trust is to engage in a commercial activity and the value of consideration paid or due in the course of the commercial activity (excluding supplies of capital property) in the previous four calendar quarters of the trust *and any associates* does not exceed $30,000, the trust should qualify as a small supplier under section 148. If the trust has just been established, it will have no revenues for the previous four quarters, but the revenues of its associates must be considered.

Section 127 sets out the concept of association for purposes of the ETA and states that a person is associated with a trust if the total value of the interests in the trust of the person and associates of the person is more than half of the total value of all interests in the trust. Section 127 offers no guidance on how the value of a discretionary interest in a trust is to be determined.[59] Section 127 also incorporates the complicated associated corporation rules from the ITA, but it contains no express reference to association between individuals. It seems that the only way individuals may be associated is if they are both associated with the same third party pursuant to subsection 127(4).

Bare Trusts

In the case of a bare trust, the department takes the view that the beneficial owners are engaged in commercial activities and are obligated to register, and the registration of the bare trust, if any, should be terminated.

[59] The department has stated that where two separate persons are the income and the capital beneficiaries of the trust, a value must be placed on the income interest and the capital interest in order for the association rule to be applied: see Revenue Canada, Excise Information System, Q & A Database [database online], 6A, Q.343.

The small supplier threshold is then calculated on a beneficiary-by-beneficiary basis.[60] As a consequence, the $30,000 small supplier threshold for a business carried on by a bare trust may be multiplied by a number up to the total number of beneficiaries of the trust, subject to the association rules.

Previously, for bare trusts that were incorrectly registered, the department gave a grace period for cancellation of registration of the bare trust and application for registration by the beneficiaries, but this grace period expired on June 1, 1993.[61] Now, in the case of incorrect registration, the department may levy interest and penalties upon the beneficial owners for not remitting GST.

A bare trustee may be engaged in commercial activities in connection with the bare trust separate from its dealings with the trust property. For example, if a trustee receives fees for acting in the role of bare trustee, it may be required to register for GST purposes in any event.

A joint venture that uses a bare trust as a means of carrying on its business activity may be able to simplify the administrative burden imposed as a result of the requirement that all beneficiaries file separately for GST purposes. Section 273 permits the operator of a joint venture and each of the co-venturers to make an election that will allow the operator to account for the GST on behalf of all of the joint venture participants. This election is available for joint ventures involved in the exploration for or exploitation of mineral deposits (including petroleum and natural gas) and certain real estate ventures. The election also may be available for other activities, treated administratively by the department as if they were qualifying activities.

Input Tax Credits for Settlor

Subsection 169(1) sets out the general rule for eligibility for input tax credits. Input tax credits are available when a person receives a supply of property or a service upon which GST is payable *during a reporting period of the person during which the person is a registrant*. The amount of the input tax credit is generally the percentage of the tax payable representing the extent to which the person *intended to use the property or service in the course of commercial activities of the person at the time the property was acquired*.

A person who settles a trust will be required to collect and remit GST as appropriate on the deemed supply under section 268 (subject to the reverse collection mechanism under subsection 221(2)). The settlor likely will already have paid GST on the acquisition of the settled property. If the settlor is not eligible to receive an input tax credit or rebate on the

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[60] TIB B-068, supra footnote 55, at 4.

[61] Ibid., at 7.

previous acquisition or the deemed supply to the trust, double taxation may result, in the sense that the settlor will have paid unrecoverable GST on property in respect of which the ultimate consumer also may pay unrecoverable GST.

Where an ongoing business entity establishes a trust to carry on an aspect of its business—for example, where a number of companies enter into a joint venture and set up a joint venture company to hold certain property in trust for the venturers and to perform certain administrative tasks—there is likely no problem with the claiming of input tax credits. The settlor will undoubtedly be a registrant who acquired the property settled upon the joint venture trust with the intention of using it in a commercial activity. But what of the non-registrant individual who acquires business property for the specific purpose of subsequently contributing the property to a trust that will carry on a business?

Even if such a person (that is, an individual) is considered a registrant because the person is required to register, his or her input tax credit may be restricted to the extent that the person acquires the property or service in the course of commercial activities *of the person*, and not the commercial activities of a different person (in this case, the trust). Subsection 141.1(3) restricts the deeming rule to activities of a person in establishing a commercial activity *of that person*. It may, however, be possible to argue that the acquisition and contribution to the trust itself constitutes a commercial activity, given the broad definitions discussed above.

The answer to the question posed above seems to be that the settlor may not be eligible to claim input tax credits, unless the settlor can be considered to be engaging in a commercial activity by way of adventure in the nature of trade in respect of property acquired for the purpose of settling it upon a trust. In most cases, however, an individual will not have an expectation of profit in respect of an acquisition of property and subsequent settlement upon a trust, so that he or she will not meet the definition of commercial activity. In any event, it is often difficult to determine with precision whether an activity constitutes an adventure in the nature of trade. The easiest route to avoid payment of unrecoverable GST by the settlor is for the settlor to settle money upon the trust, rather than purchase property and settle the property upon the trust. The trust would then use the money to purchase the desired property.

GST Consequences of Ongoing Trust Activities

Application of General Rules

As noted above, if a trust is engaging in commercial activities and is not a small supplier, it is required to register under section 240 on making its first taxable supply and will be considered a registrant at that time. With respect to the ongoing commercial activities of a trust, there are few special or unique rules in the ETA; the general GST rules apply to the trust as if it were any other person. Basically, the trust is required to collect and remit GST on its taxable supplies, and to file GST returns, and it may claim input tax credits for the GST paid on its taxable purchases.

Real Property Supplies Where Beneficiaries Are Individuals

One exception to the general GST rules for trusts is section 9 of part I of schedule V of the ETA, which exempts a supply of real property (other than capital real property used primarily in the business of the trust or real property sold in the course of the business of the trust) made by way of sale by a trust *all of whose beneficiaries are individuals* (or charities that are contingent beneficiaries). This exemption is not likely to apply for the benefit of trusts carrying on business activities owing to the exclusions in paragraphs (a) and (b) of the provision. However, perhaps the very broad definition of "business" (which includes an undertaking of any kind whatever) encompasses investment activities that may not be considered "business" in other contexts (such as the ITA). In that event, it is questionable whether the exemption would ever apply to the supply of real property from a business trust under any circumstances.

Bare Trusts

A bare trust is ignored under the department's policy for the purposes of determining GST consequences of ongoing activities of the "trust." The department considers the beneficial owners of the trust property to be engaged in commercial activities and in the making of supplies. It is they who are obligated to register and to collect and remit GST on taxable supplies made by the "trust," and they who are entitled to claim input tax credits.[62] A potential benefit of this administrative policy is that the small supplier test will be applied on an individual basis if the beneficial owners are not associated. For example, if the bare trust carries on commercial activities generating up to $120,000 in annual revenues and the beneficial interest is shared by four individuals in equal proportions, each of the beneficial owners may be considered a small supplier with respect to the commercial venture.

The department takes the position that input tax credits may not properly be claimed by a bare trust since it is not engaged in commercial activities. Now that the grace period allowed by the department has expired, beneficiaries must be especially vigilant in determining whether their trust is "bare." If a bare trust claims input tax credits that are subsequently disallowed, the department will recover the credits and may impose interest and penalties. The beneficiaries should, however, be able to claim their entitlement to the disallowed input tax credits as long as they file a return within the four-year limitation period provided for in subsection 225(4).

Undisclosed Agency

Section 177 may be relevant where a bare trust/agency relationship exists. Subsection 177(1) applies where a registrant agent makes a taxable supply on behalf of a registrant principal in the course of the agent's

[62] Ibid., at 4 and 6.

commercial activities and does not disclose to the recipient in writing the principal's name and GST registration number. In these circumstances, the principal is deemed to have made a supply to the agent and the agent is deemed to have made a supply to the recipient.

GST Consequences on Distribution of Trust Property

Section 269 appears to apply to any distribution from a trust to a beneficiary.

General Rule: Section 269

Section 269 provides that where a trustee distributes trust property to beneficiaries, the distribution is deemed to be a supply of the property by the trust for consideration equal to the proceeds of disposition determined under the ITA. Similar to section 268, the rule deems a supply to have been made but does not affect the character of the supply. If the property distributed would otherwise be an exempt or zero-rated supply, it will remain exempt or zero-rated in the course of the distribution.

"Distribution"

A distribution of property from a trust or an estate to the beneficiaries is generally thought to be different from a purchase and sale. Often, a distribution represents a transfer of trust or estate property to a beneficiary in reduction or in satisfaction of the beneficiary's interest in the trust or estate.[63] This is the manner in which the term appears to be used in subsection 267(2), where it refers to the duties of an executor. Presumably, section 269 will not apply to a purchase of property by a beneficiary from the trust, although GST could be payable under the general rules.

Proceeds of Disposition/Consideration

When a distribution of trust property is made, the proceeds of disposition as determined under the ITA are not necessarily equal to the fair market value of the property. For example, paragraph 107(2)(a) of the ITA deems a trust to have disposed of property for proceeds equal to its cost amount where it is distributed in satisfaction of a capital interest. This provision does not apply, however, to distributions from a trust that is not a "personal trust."

Character of Supply

To be a taxable supply, the distribution must be made in the course of a commercial activity. The deeming rule in subsection 141.1(3) may be relevant to a trust distribution, since it deems activities carried out in

[63] Subsections 106(3) and 107(1) to (5) of the ITA refer to a distribution of trust property in the context of its being received in satisfaction of all or part of a beneficiary's interest in the trust. See also the definition of this term in *Jowitt's Dictionary of English Law*, 2d ed.

furtherance of the disposition or termination of a commercial activity to be carried out in the course of a commercial activity. As a result of this deeming rule, GST may be payable on a windup distribution of trust property after the trust has ceased its commercial activity.

Constructive Trust

As discussed under the heading "Constructive Trust" above, a declaration of a constructive trust as a restitutory remedy may be subject to section 268. There is also a potential application of section 269 on a distribution of property that has been subject to a constructive trust to the beneficiaries. Since a constructive trust is a trust at law, there is no apparent reason why a transfer of property from the present holder, presumably the trustee, to the beneficiaries should not be treated in the same manner as a regular trust distribution.

Distribution from an Estate

Figure 3 (which parallels a segment of figure 1) identifies some of the issues that should be considered in the context of a distribution of property from an estate to a beneficiary.

Subsection 167(2) Election

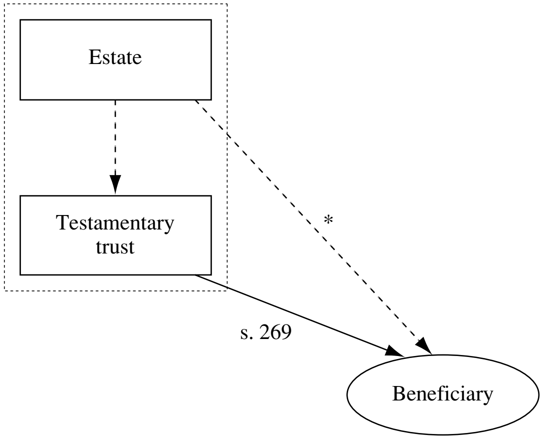
Subsection 167(2) provides a rule that may apply where business property is distributed from an estate to an individual who uses the property in the course of his or her commercial activities. If this rule applies, no tax is payable and the recipient of the property is deemed to have acquired the property for use exclusively in commercial activities.

For this rule to apply, the first requirement is that the decedent must have held property for consumption, use, or supply in the course of a business carried on immediately before death. Thus, the rule will apply in the situation of a deceased proprietor.

The second requirement is that the decedent's personal representative must make a supply of the property, in accordance with the decedent's will or the laws of succession, to an *individual* beneficiary of the decedent's estate who is a registrant. A beneficiary that is not an individual will not qualify. A bequest to a testamentary trust does not appear to fall within this aspect of the rule, since the ETA treats a trust as a separate person but not as an individual.

As indicated above, the individual beneficiary must also be a registrant. A deceased proprietor may leave the assets of his business to an unregistered individual who is not engaged in commercial activities but intends to carry on the decedent's business. In this situation, the individual may attempt to rely on paragraph 141.1(3)(a), subsection 240(1), and the definition of "registrant" in subsection 123(1) to argue that he or she is a registrant at the time of the bequest. Subsection 240(1), however, is of assistance only where the individual has made a taxable supply in Canada in the course of a commercial activity. Further, paragraph

Figure 3



——— depicts supplies that are specifically contemplated by the ETA

- - - - - - - depicts supplies that may not be specifically contemplated by the ETA; accordingly, the general rules will apply

.... depicts the boundaries of what might be viewed as a single separate person for purposes of the ETA

* depicts possible application of subsection 167(2) on a distribution from an estate; however, this provision has limited application

141.1(3)(a) applies at the moment the business property vests in the individual, which may be too late to satisfy the requirement of paragraph 167(2)(b) that the individual be a registrant at the time of the supply. As a result, subsection 167(2) may be of use only when the individual beneficiary is a registrant before the death.

The third requirement of this rule is that the property must be received by the individual beneficiary for consumption, use, or supply in the course of commercial activities of that individual. There is no requirement that the business of the decedent be continued or that the property be used in the particular commercial activities previously carried on by the individual beneficiary. It is only necessary that the property be used or supplied in the course of commercial activities of the individual beneficiary.

Former paragraph 167(2)(d) required the personal representative and the beneficiary to make a joint election with the minister before the rule would apply. Under the new amendments, the requirement to file the election with the minister has been removed effective April 27, 1992.

No Election

In circumstances where the election in subsection 167(2) does not apply, the appropriate GST treatment is unclear, particularly the interaction between sections 267 and 269.

The provisions of section 269 of the ETA are stated to be "subject to sections 265 to 267." This wording raises the question how section 269 is subordinate to section 267. Section 267 applies on the passing of property to a person's executor on that person's death. In contrast, section 269 applies upon the distribution of trust property to the trust beneficiaries. In view of the different spheres in which these supplies occur, it is difficult to conceive how these rules overlap such that one may be said to be subject to the other.

One possibility is that section 267 is a complete code insofar as estates are concerned, so that section 269 does not apply at all on a distribution of property to beneficiaries of an estate. Since section 267 does not contain any specific rule in regard to a transfer of property out of an estate, the argument would be that no rule was intended and such distribution could take place without the application of GST; that is, it would be outside the application of the ETA. In the absence of a deeming rule, the beneficial interest in the property would vest in the heirs on the death of the decedent, such that the distribution out of the estate would simply be a transfer of bare legal title of nominal value, with no GST payable. This position draws support from the fact that "trust" and "estate" are treated as separate concepts in the ETA.[64] On its wording, section 269 does not appear to apply to an estate.

This suggestion requires one to read a great deal into the words "subject to section . . . 267" in section 269. It is unlikely that the legislators intended such a broad result to flow by implication from this wording. In effect, under this interpretation, a distinction in tax consequences arises between distributions from trusts and distributions from estates, with no clear policy rationale for the difference in treatment. The more appropriate interpretation is that section 267 is limited by its terms to the supply of property from the deceased to the executor, and that it does not exclude the operation of section 269 from the distribution of the property by the executor to the beneficiaries. This reasoning is further supported by the existence of subsection 167(2) of the ETA, which would not be necessary if section 267 were a complete code. The problem with this approach, however, is that it seems to render the "subject to" wording in section 269 superfluous, unless it contemplates a highly unusual situation of questionable legal validity in which a decedent held property in trust for his or her own estate.

The department's interpretation on this issue is not entirely clear. The department has stated:

> It is often the case that, when the executor distributes property, there is no tax payable because the transfer is without consideration and the executor is not acting in the course of commercial activity. This would be the case where the executor distributes the personal, non-commercial property of the deceased.

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[64] See, for example, the definition of "person" in subsection 123(1), which refers to "trust or estate," and the discussion above under the heading "Estate/Testamentary Trust."

> Where, however, there are proceeds of disposition with respect to a particular distribution under the *Income Tax Act*, there will be deemed to be a supply for consideration equal to those proceeds. If the property distributed were such that, if supplied by the deceased, it would have been taxable, then the supply by the estate will also be taxable.[65]

The department takes the position that an estate is treated as a trust for purposes of section 269, such that proceeds as determined under the ITA will be relevant, and that the ETA should be applied as if the deceased were making the supply. If the beneficiary does not register for GST purposes before the transfer, the GST must be paid and no input tax credits will be available (although the department suggests that an input tax credit may be available on registration by application of the change-of-use rules).[66]

The technical basis for the department's administrative approach appears to be that the deeming rules in paragraph 267(1)(c) (executor deemed to use property in same manner as decedent) and paragraph 267(1)(d) (executor deemed to be engaged in commercial activity where decedent was so engaged) are applied on a property-by-property basis and section 269 is applied to all distributions: a distribution of property that had not been used by the decedent in the course of a commercial activity would be deemed to be a supply for consideration equal to the amount determined under the ITA, but it would not be deemed to have been made in the course of a commercial activity and therefore would not be a taxable supply. This appears to be a common-sense approach, and it is consistent with the department's administrative practice as stated in a private letter.[67]

If the legislation were to be applied by treating a trust and an estate separately such that section 269 applied only to distributions from a trustee, the general rules of the ETA would apply. One would have to inquire, first, whether there were deemed proceeds of disposition under section 155 of the ETA and, second, whether the supply was made in the course of a commercial activity.

It has been suggested that, to resolve the uncertainties in interpretation of these provisions, a dichotomy may be drawn between a person acting as an executor and a person acting as a trustee.[68] Section 267 would apply when the person acted as an executor in administering the estate (similar to the administrative capacity of a trustee in bankruptcy under section

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[65] Revenue Canada, Excise Information System, Q & A Database [database online], 7I, Q.15.

[66] See "94 CRT 04" (January 1995), 1 *Access to Canadian Commodity Taxes* 24-25, for Revenue Canada's response to question 3 from the February 1994 Revenue Canada round table in Winnipeg, Manitoba.

[67] See Wong, supra footnote 41, at 133, footnote 72, where the department is quoted as saying in a private letter dated October 4, 1991 that "[f]or the purpose of administering section 269, the Department will treat an estate as a trust and apply the section to distributions of property from an estate."

[68] Albrecht, supra footnote 38, at 39:7.

265 and a receiver under section 266) but would not be relevant when the person acted in the capacity of trustee (for example, where he or she managed a testamentary trust). The distinction between the capacities of executor and trustee may, however, be difficult to draw, since an executor who merely gathers in the decedent's property and distributes it according to the terms of the will (that is, when no testamentary trust is created) is acting in a purely administrative capacity. However, for the legislation to operate as the drafters apparently intended, the distribution of the property from the estate must be subject to section 269. As a result, under this proposed interpretation, the act of distribution cannot be considered to be undertaken in the person's capacity as executor.

Not a Deemed Sale

One notable difference between sections 268 and 269 is that section 268 deems both a supply and a sale to have occurred on the settlement of a trust, while section 269 deems only a supply on a distribution. This distinction may be important for purposes of determining whether or not the distribution constitutes an exempt supply. Part I of schedule V sets out the detailed rules governing the exempt status of certain supplies of real property, and the rules focus on a supply *by way of sale*. If a trust distributes real property to its beneficiaries, and the property would otherwise be exempt pursuant to part I of schedule V, is the deemed supply exempt?

The existence of the deeming rule for a sale in section 268 indicates that the legislators turned their minds to the distinction between a supply and a supply by way of sale, and chose not to deem a distribution from a trust to be a sale. Principles of statutory interpretation support the view that a distribution from a trust is not a sale, but this technical interpretation is doubtful given the broad definition of "sale" in the ETA, which includes any transfer of ownership (presumably covering either legal or beneficial ownership). The result of a conclusion that a distribution is not a supply by way of sale is that a distribution from a trust of otherwise exempt real property (deemed to be made in the course of a commercial activity by virtue of subsection 141.1(3)) may be a taxable supply, and GST will be payable by the beneficiaries—that is, section 9 of part I of schedule V will not apply. The policy rationale for this result is unclear.

Beneficiaries wishing to receive a distribution of otherwise exempt real property and to minimize the risk that the supply is not exempt could consider purchasing the property from the trust,[69] subject to relevant considerations under the ITA and the terms of the trust. The supply by way of sale would qualify as an exempt supply, and the trust could subsequently distribute the cash (or other consideration, such as a note payable) received as proceeds of the sale to the beneficiaries free of any GST.

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[69] Note that if the trust property is sold for proceeds less than its fair market value, and the beneficiaries do not deal at arm's length with the trust, section 155 may deem the sale to have occurred at fair market value.

Another possible implication of the absence of a deemed sale is loss of small supplier status. Paragraph 148(1)(a) excepts from the calculation of amounts relevant to the $30,000 limit "supplies *by way of sale* of capital property of the person [emphasis added]." If a distribution of capital property from the trust is not considered a sale, it will not be excluded from the calculation. The trustees may wish to consider a sale of the property to the beneficiaries and subsequent distribution of proceeds, rather than a direct distribution of the property, to ensure that the distribution will not affect the trust's small supplier status.

Another potential planning point for a sale of real property of the trust to the beneficiaries where the property is not exempt is for any unregistered beneficiaries to become registered and thereby relieve the trust of its obligation to collect GST by virtue of paragraph 221(2)(b). This rule is an exception to the collection rule where a supply of real property by way of sale is made to a registered recipient (and the supply is not of a residential complex made to an individual). If the beneficiaries will be using the real property in the course of their own commercial activities, they may claim an input tax credit to offset their GST liability as reported on form GST 60, and the parties need not be concerned about cash flow problems.

Exceptions for Taxable Supplies

As discussed above under the heading "Exceptions for Taxable Supply," a distribution of trust property as a taxable supply may be eligible for an exception to GST liability on the basis of small supplier status of the trust (subject to the complications discussed in the previous section) or on the basis of the "supply of a business" exception in section 167.

Clearance Certificate

Section 270 requires a "representative" of a registrant to obtain a clearance certificate from the minister certifying that GST amounts owed by the registrant and amounts expected to become payable by the representative have been paid or that acceptable security has been posted. The representative must obtain the certificate before making any distribution of money or property, and failure to do so will make the representative directly liable for unpaid tax up to the value of the distribution.

A "representative" is defined for this purpose to mean a person who is administering, winding up, controlling, or otherwise dealing with any property, business, commercial activity, or estate of a particular person. This broad definition appears to catch trustees, who should consider the necessity of obtaining a clearance certificate before making a distribution of trust property where the trust is a registrant.

Transactions Involving Estate/Trust Interests

As noted earlier, the definition of "financial instrument" in subsection 123(1) includes an interest in a trust, and any right in respect of that interest. The issuance, granting, and transfer of ownership of a trust interest should therefore fall within the definition of "financial service" in subsection 123(1), as should the payment of any benefits or other amounts in respect of the trust interest. Financial services are considered exempt supplies pursuant to part VII of schedule V of the ETA (unless made by a financial institution to a non-resident, in which case they are zero-rated under part IX of schedule VI).

The result of these rules is that trust interests may be created, bought, and sold without liability for GST. Like the sale of corporate shares, the sale of trust interests is an alternative to the sale of the property itself, and all of the relevant tax considerations under the ITA and the ETA must be examined before a decision to sell is made. If a purchase and sale of property is structured to take place through a trust, such that trust interests are sold rather than the property itself in order to avoid GST, consideration must be given to the potential application of the general anti-avoidance rule under the ETA.[70]

The definition of financial instrument does not include a reference to an interest in an estate. Although the transfer of an interest in an estate would likely be a rare event, the technical question arises whether a supply of such an interest constitutes a financial service. Further, a very technical reading of the ETA suggests that it is not clear whether the creation of a beneficial interest in an estate is an exempt supply, since the terms of section 267 apply only to the executor. This is yet another area of uncertainty that needs to be addressed.

There was initially some question, regarding the definition of financial service in subsection 123(1), whether the conferral of a benefit on the beneficiaries by a trust otherwise than by payment of money would qualify as an exempt supply. The amended version of the definition makes it clear that only benefits conferred by way of payments of money will be included as a financial service.

TRUSTEE COMPENSATION

With regard to fees paid to trustees and executors, an assessment must be made as to whether the trustee or executor is performing his or her duties in the context of a commercial activity. It is doubtful that an individual trustee or executor could escape the definition of commercial activity on the basis of the argument that he or she had no reasonable expectation of profit, unless there was clear evidence that expenses incurred in the course of the administration exceeded the fees paid. A trustee or executor may, however, be able to argue that the provision of trustee or executor services, if it is an isolated activity, is not part of a business or an adventure in the nature of trade. Alternatively, the trustee or executor may be able to avoid GST through the small supplier rules if he or she has not received revenues from taxable supplies in excess of $30,000 in the previous year.

[70] Section 274.

A trustee or executor could argue that he or she is not undertaking a commercial activity on the basis that the position of executor or trustee is an "office," which is specifically excluded from the definition of "business" in subsection 123(1). The definition of "officer" in subsection 123(1) is quite broad and includes "the incumbent of any other office who is elected or appointed to act as a representative of a group of persons." The department has drawn a distinction between an executor who may hold his or her position as an officer and one who holds the position as a business activity.[71] Fees charged by a trust company for administration of a trust are generally taxable.[72]

CONCLUSION

The first essential task in addressing the relevance of the trust rules in the ETA is to make the legal determination whether a trust exists under private law principles. A "trust" refers to a relationship that imposes equitable obligations on the person holding the property to deal with it for the benefit of the beneficiaries. Prerequisites to the existence of a trust include certainty of intention, of subject matter, and of objects. A "bare trust" may not be a trust at all, but rather a form of agency, such that the trust taxation rules do not apply.

Generally, the ETA treats trusts and estates as separate taxpayers. The creation of an estate on the death of an individual appears not to be subject to GST, while the settlement of an inter vivos trust is deemed to be a supply. Any distribution of property from a trust also is deemed to be a supply. Transactions involving interests in a trust are generally exempt financial services. Otherwise, the provisions of the ETA operate on trusts and estates in the same manner as they operate on other persons.

The trust and estate provisions of the ETA are sparse and poorly drafted, and leave many issues unresolved. The legislation appears to treat a trust and an estate as separate concepts, consistent with their divergent legal meanings, but many provisions refer only to a trust and not to an estate. There is no rule in the ETA that has the effect of considering a reference to an executor or a trustee to be a reference to the estate or trust. In this regard, section 267 of the ETA refers only to the executor and not the estate. The department seems to have adopted administrative positions that are not entirely consistent with the language of the legislation, simply to make the rules operate in an appropriate manner. We recommend that the Department of Finance undertake efforts to amend the existing legislative wording to clarify how the trust and estate rules are intended to operate.

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[71] See Wong, supra footnote 41, at 131; and Revenue Canada, Excise Information System, Q & A Database [database online], 3D, Q.21, in which the department states that it will take the same approach to this issue as it takes under the ITA, such that an executor not acting in the course of carrying on a business will be considered to act in an "office." This position was subsequently confirmed in a letter dated December 30, 1994, with a specific quotation from paragraph 5 of *Interpretation Bulletin* IT-377R, January 27, 1989.

[72] See Revenue Canada, Excise Information System, Q & A Database [database online], 5A, Q.24.