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1988 DECEASED PERSONS' INCOME TAX GUIDE

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This Guide is not a legal document. It uses non-technical language to explain some of the laws about income tax, unemployment insurance, and the Canada Pension Plan. For official purposes, please consult the *Income Tax Act*, the *Unemployment Insurance Act*, the *Canada Pension Plan*, and their related Regulations.

INTRODUCTION

This Guide contains information of particular use to representatives (executor or administrator) of deceased taxpayers. It refers to the *1988 General Tax Guide* and to the *1988 T1 General Income Tax Return*. If a *1988 T1 Special Income Tax Return* is filed, the *1988 General Tax Guide* and this Guide may be used in conjunction with the *1988 Special Tax Guide* by cross referencing to the particular income, deduction or non-refundable tax credit shown on that return.

There is no specific income tax return for a deceased taxpayer. Where a T1 Special return has been received on behalf of the deceased and the income, deductions and non-refundable tax credits of the deceased are such that a T1 Special return may be used, that return may be filed on behalf of the deceased. Otherwise, the T1 General return should be used.

FILING OF RETURNS

The representative of a deceased taxpayer must file any required income tax return(s) for that person. If filing before the current year returns are available, use the prior year's T1 General return and change the year at the top of page 1. Depending upon the various sources of income of the deceased taxpayer and whether certain elective provisions of the Income Tax Act are exercised, it is possible to file as many as four separate income tax returns for the year of death, as outlined below:

Ordinary Return

- A return must be filed for the year in which the taxpayer died, covering the period from January 1 of the year of death to the date of death. This return must be filed either by April 30 of the year following the year of death or six months after the date of death, whichever is later. If a spouse trust exists, the deadline for filing the deceased's return may be extended to 18 months after the date of death.

Elective Returns

- The deceased may have been a member of a partnership or may have carried on a proprietorship business with a fiscal period other than the calendar year. Where the taxpayer died in a calendar year and the fiscal period of the business ended in the same year but before the date of death, the business income from the end of the last fiscal period to the date of death is to be reported on the return filed for the year of death, even though it represents income for more than a twelve-month period. An elective procedure is available to report this income on a separate return filed by April 30 of the year following the year of death or six months after the date of death, whichever is later. If a spouse trust exists, the deadline for filing the deceased's return may be extended to 18 months after the date of death.

- Where the deceased was an income beneficiary of a testamentary trust with a fiscal period other than the calendar year, a separate return may be filed. This return is required to be filed by April 30 of the year following the year of death, or six months after the date of death, whichever is later. This return would include the income from the trust for the period from the end of the last fiscal period to the date of death. If a spouse trust exists, the deadline for filing the deceased's return may be extended to 18 months after the date of death.

- The representative of the deceased may also elect to file a separate return for

the value of "rights or things" at the date of death. This return is required to be filed within one year after the date of death, or 90 days after the mailing of any notice of assessment of tax for the year of death, whichever is later. Refer to Part II, item 1 of this Guide for further information on rights or things.

If a taxpayer died before the immediately preceding year's return was required to be filed the filing deadline for that previous year's return is extended to six months after the date of death.

PART I
ORDINARY RETURN TO DATE OF DEATH

1. Identification area of the return

If a personalized return is used, make sure all the information at the top of the return is accurate. The name of the taxpayer should be changed to read "The Estate of the Late ..." and the address should give the name and address of the executor or administrator. The reference to province or territory of residence on December 31 refers to the residence at the date of death. The date of death should be entered in the appropriate area.

2. Calculation of total income

In order to complete the income area of the return, it is necessary to determine the deceased person's income from all sources. A copy of the deceased person's immediately preceding year's income tax return may be of assistance.

In some instances, such as in the case of early-filed returns, it may be necessary to contact the payer of the sources of income in order to obtain information slips. If the payer is unable to supply an information slip, a confirmation by letter or some other written evidence of income will be acceptable. If such confirmation or evidence cannot be obtained, estimate the income and attach a note to the return stating the amount received and the name and address of the payer.

If a T4 slip is missing, estimate the income, the related payroll deductions such as Canada or Quebec Pension Plan contributions, Unemployment Insurance premiums and tax deducted at source. Attach a letter to the return explaining the situation and stating the estimated amounts. Be sure to give the employer's name and address, and attach any pay slips on hand.

All types of income described on the return must be reported if received by the deceased, even if no information slip was received.

Income that is payable periodically, such as interest, rents, royalties, annuities, or salaries and wages, is deemed to accrue in equal daily amounts in the period for which the amount was payable. This does not apply to annuity contracts deemed to have been disposed of on death. Any amount not actually received before the taxpayer's death but deemed to have accrued to that date is included in the deceased's ordinary return for the year of death. Obtain Interpretation Bulletin IT-210R, *Income of Deceased Person – Periodic Payments*, for additional information.

Certain income received after the date of death should be reported on the ordinary return for the year of death or may be reported on the special return for "rights or things," if that filing option is exercised. Refer to Part II, item 1 of this Guide for more information concerning rights or things and a list of these income items. Amounts,

other than those considered rights or things, which are received after the date of death are income of the beneficiaries or the estate and are considered death benefits. For information on what constitutes death benefits and how they should be reported refer to item "C" under line 130 of the *1988 General Tax Guide* and to Interpretation Bulletin IT-508, *Death Benefits – Calculation*.

The line numbers listed below refer to lines on the General/Special income tax return. Only the most commonly-used lines are explained.

Lines 101 to 104 – Income from employment
Include all amounts of salary or wages received from January 1 to the date of death and amounts accrued from the beginning of the pay period in which an employee dies to the date of death.

Lines 113 to 115 – Pension income
Include all amounts of pension or superannuation income attributable to the deceased for the period between January 1 and the date of death. Do not include in the income of the deceased "Net Federal Supplements Paid" shown in Box (H) of the T4A(OAS).

Lump sum payments paid out of or under a pension fund or plan as a result of death, including a death benefit paid under the Canada or Quebec Pension Plans, will normally be taxable in the hands of the recipient. The recipient may be either a beneficiary, such as the spouse, or children, or the estate. For information on how to report lump sum payments refer to item "C" under line 130 of the *1988 General Tax Guide*, and to Interpretation Bulletin IT-301, *Death Benefits – Qualifying Payments*.

Line 118 – Family allowance payments
If the deceased had been married up to the date of death, the spouse with the higher net income (before including family allowance and deducting child care expenses) must report the family allowance received for the year. If the taxpayer had been separated from his or her spouse as a result of a marriage breakdown for a period of 90 days starting in the year of death,

- the family allowance payments for all months at the end of which the individual was separated must be reported by the recipient, and
- the family allowance payments for each other month must be reported by the spouse with the higher net income for the year.

Lines 120 and 121 – Investment income
Investment income from January 1 to the date of death, to the extent it was not reported in a prior year and amounts accrued in that period but not yet paid are included here. Generally, interest from bonds would include interest accrued from the last interest date preceding the death to the date of death. Interest accrued on compound interest bonds to the date of death and not already included in income in a prior year is income of the deceased person. Certain amounts of investment income may be reported as rights or things on a separate return. Refer to Part II, item 1 of this Guide for more information.

Line 129 – Registered retirement savings plan (RRSP)
If the deceased person was an annuitant under a registered retirement savings plan, and the deceased's spouse is entitled, as a beneficiary under the plan, to receive the amount in an unmatured plan, the amount so received is a "refund of premiums" and is included in the income of the spouse. If there is no spouse but certain dependent children are beneficiaries under the plan, the amount received as a "refund of premiums" is income of the children.

The fair market value of the property in an RRSP at the date of death must be included in the income of the deceased to the extent it exceeds the amount receivable by the spouse and the amounts paid and constituting "refund of premiums" to certain dependent children. Where an amount is paid out of an RRSP to the deceased's estate, the representative and a beneficiary of the estate may jointly elect to treat part or all of such amount as having been received by the beneficiary as a "refund of premiums," provided that the elected amount could have qualified as a "refund of premiums" had it been paid out of the RRSP directly to the beneficiary. This designation may be made by filing form T2019, *Registered Retirement Savings Plan (RRSP) Refund of Premiums Designation – Spouse*. You may also use this form to designate a "refund of premiums" to a child or grandchild. Form T2019 is available at any district office.

Under certain circumstances, a "refund of premiums" to a named beneficiary may be transferred to an annuity or to a registered retirement savings plan in the name of the beneficiary. For more information regarding amounts paid out of an RRSP as a result of death, obtain Interpretation Bulletin IT-500, *Registered Retirement Savings Plans (maturing after June 29, 1978) – Death of Annuitant after June 29, 1978*, and the *1988 Pension and RRSP Tax Guide*.

Lines 130 to 143 – Other types of income

The remaining lines on page 1 of the return cover the other types of income that must be reported. Information on the various types of income and the required schedules may be found in the *1988 General Tax Guide*. If the deceased owned capital property at the date of death, see Part III, *Deemed Disposition of Capital Property at Death*, of this Guide.

Reserves in year of death

In computing income from a business and in computing a gain from the disposition of capital property, provision is made for the deduction of reserves for the income element of the proceeds of sale that are not receivable until a later taxation year. A somewhat similar provision permits an insurance agent or broker a deduction of a reserve in respect of unearned commissions.

Such reserves may not be claimed in the year of death unless the right to receive such uncollected proceeds is transferred or distributed to a spouse or spouse trust, and the representative and the transferee jointly make an election in prescribed form in respect of such property. The form to be used is form T2069, *Election in Respect of Amounts Not Deductible as Reserves for the Year of Death*. The deceased taxpayer, as well as the spouse to whom the property right is transferred, must have been resident in Canada immediately before the death of the taxpayer. An amount equal to such reserves claimed in an election is included as income from business, resource property, capital property or commissions, as the case may be, in computing the income of the spouse or spouse trust for the first taxation year ending after the death.

If the right to receive such uncollected proceeds is not transferred to a spouse or spouse trust the reserve must be included as income of the deceased and reported as a capital gain.

New for 1988

Where a capital gain reserve, arising from dispositions of property occurring after 1984, is reported by the spouse, spouse trust or as income of the deceased taxpayer this amount would qualify for purposes of the capital gains deduction.

3. Lines 207 to 232 – Deductions from total income

Follow the instructions in the *1988 General Tax Guide*.

4. Line 237 – Accumulated forward averaging amount withdrawal

There are various options available for an individual with forward averaged amounts who died in 1988. If the representative decides to do nothing with respect to the amounts previously forward averaged there will be no further tax consequences. On the other hand, he or she may elect to bring back into the deceased's income for the year of death all or part of the forward averaged amounts. In this case, the income may be taxed at a reduced rate under special provisions. If such an election is made in respect of only a portion of the previously forward averaged amounts, there will be no further tax consequences on the remainder, unless the representative elects to have the three year carryback provision apply on the remainder. In order to calculate the tax on the forward averaged amount obtain form T541, *Forward Averaging Tax Calculation – Deceased Taxpayers*, from any district office.

Note: This form must be submitted on or before the date on which the return for the year of death is required to be filed.

5. Deductions from net income

Line 253 – Capital losses of other years

There are special rules regarding the application of capital losses in the year of death. Refer to Part IV of this Guide for more information.

Follow the instructions in the *1988 General Tax Guide* for the remaining deductions from net income.

6. Calculation of total non-refundable tax credits

New for 1988

Beginning in the 1988 taxation year, personal amounts and many other deductions used to calculate taxable income have been converted into non-refundable tax credits. These credits are calculated in the section entitled "Calculation of Total Non-Refundable Tax Credits" on page 2 of the *1988 T1 General Income Tax Return* and are explained in detail in the *1988 General Tax Guide*.

Lines 300 and 301 – Personal amounts

Personal amounts are not prorated to the date of death. The maximum basic personal amount may be claimed and, if the deceased reached age 65 before death, the maximum age amount may also be claimed.

Line 303 – Married amount

The deceased is entitled to a full married amount for a spouse whose income, **for the entire year,** was not more than $500. A partial amount may be claimed if the spouse's income, **for the entire year,** was more than $500 but less than $5,500. Alternatively, the surviving spouse may claim the married amount with respect to the deceased in the same manner, unless the surviving spouse, due to insufficient income prior to the spouse's death, was not in a position to support the latter. This would apply even where the deceased's income, in the year of death, was not more than $500. Where the surviving spouse claims the married amount, he or she must

use the deceased's net income from all returns filed for the year of death in calculating the married amount.

Note: The income of the surviving spouse for the entire year, rather than to the date of the deceased's death, must be used in calculating the married amount. If claiming children and other dependants, their income for the entire year must also be used when calculating the personal amounts.

Lines 304 and 305 – Amounts for dependent children and other dependants
Personal amounts for dependent children, and amounts for other dependants must be claimed on Schedule 6. Only the person reporting the family allowance payments may claim the "amounts for dependent children" for the child for whom the payments were received. If more than one person must report the family allowance received for the same child both may claim the "amounts for dependent children" for the child in the same proportion the family allowance is reported. However, the combined claim made by the deceased and the other person for each dependant may not be more than the maximum amount allowable for that child.

Line 314 – Eligible pension income
If prior to death, the deceased received eligible pension income such as a life annuity from a pension or superannuation fund, an amount equal to the amount received in the year or $1,000, whichever is less, may be claimed for tax credit purposes. However, if a portion of any pension income was rolled over to a registered retirement savings plan or registered pension plan a claim cannot be made unless the deceased **reached age 60 before death,** or was **under 60 years of age at the date of death** and

- was in receipt of a disability pension or survivor's pension under the Canada or Quebec Pension Plans, or
- for the 1988 taxation year, had transferred a refund of undeducted past service additional voluntary contributions to a registered pension plan. The contributions to the registered pension plan must have been made before October 9, 1986.

Note: For certain types of pension income, the credit is allowable only if the deceased reached age 65 before death. Please refer to the *1988 General Tax Guide* to determine the allowable amount.

Lines 316 and 318 – Disability amount
This amount may be available if the deceased was severely impaired (mentally or physically) in 1988, and where the impairment

- markedly restricted the individual in his or her activities of daily living, and
- lasted or **was expected** to last for a continuous period of at least 12 months.

The disability amount may not be claimed if a claim is made under medical expenses for a full-time attendant or care in a nursing home by reason of the mental or physical impairment. The medical expenses or the disability amount may be claimed, whichever is more favourable, but not both. If the disability amount is claimed, do not prorate it to the date of death. Claim the full amount.

Line 326 – Amounts transferred from spouse
If the spouse of the deceased has certain amounts available that are not required to reduce his/her federal income tax to zero, any unused portion of these amounts

may be transferred to the return of the deceased. Note, however, that the spouse's income for the entire year must be considered.

Similarly, if these amounts are not required to reduce the deceased's federal income tax to zero, any unused portion of these amounts may be transferred tc the surviving spouse.

Refer to Schedule 2 in the *1988 T1 General Tax Return* package.

Line 330 – Medical expenses
Medical expenses for the deceased may be claimed for any 24-month period that includes the date of death, where such amounts have not previously been claimed and the total expenses were more than $1,500 or three per cent of the deceased's net income, whichever is less. If making such a claim, complete Schedule 5 in the *1988 T1 General Tax Return* package and attach it and all receipts to the return.

Line 340 – Charitable donations
Claim all charitable donations made in the current year and in the five immediately preceding years that were not previously claimed. If the claim includes amounts carried forward from 1983 or subsequent taxation years, state this on the return. However, donations made in 1983 cannot be claimed if the deceased taxpayer had claimed the optional standard $100 deduction for that year. Official receipts must be filed with the return.

Charitable donations made in the year of death by a deceased person may be deducted in the immediately preceding year if they are not claimed in the year of death. Bequests contained in the will of the taxpayer made to registered charities may be claimed in the year of death, if amounts can be established through proper receipts.

Line 342 – Gifts to Canada, a province or gifts of cultural property
Gifts made to Canada, a province or to an institution for property certified by the Canadian Cultural Property Export Review Board may be claimed. Gifts made in the year of death may also be deducted in the preceding year.

Refer to Part V. item 3 "Charitable Donations or Gifts by Will," of this Guide for more detailed information.

7. Summary of tax and credits

Refer to the Tax Tables in the *1988 General Tax Guide*. Read the instructions carefully to decide whether the tables may be used. If it is decided not to use the tax tables then use Schedule 1, *Detailed Tax Calculation*. All items described under the heading "Summary of Tax and Credits" in the *1988 General Tax Guide* are applicable in the year of death.

Note: If the deceased had paid minimum tax for 1986 or 1987, part of that tax may be deducted from the 1988 taxes payable. To calculate this claim, complete Part VII of form T691, *Calculation of Minimum Tax*. Attach the completed form to the return. It should be noted however that, in the year of death, minimum tax is not applied for that year.

Line 446 – Federal sales tax credit
This credit may be claimed on the return of either the deceased or the surviving spouse. The deceased's net income from all returns filed for the year of death must be included in the "Calculation of Income" area that appears with Schedule 8.

Provincial or Territorial tax credits

A number of provinces have tax credit systems that work through the personal income tax system. In some cases, the deceased may be entitled to the applicable tax credit. This credit is calculated on the Provincial or Territorial Tax Credit form included with the *1988 T1 General Income Tax Return* package. Information or assistance in completing such a tax credit form is available from any district office.

PART II
ELECTIVE RETURNS

1. Rights or things

The taxpayer may have had at the time of death "rights or things" (other than any capital property) the amount of which, had the taxpayer not died, would have been included in income when realized or disposed of. The value of these rights or things at the time of death must be included in computing the taxpayer's income for the year of death.

The following are examples of rights or things:

Other Rights or Things

- matured uncashed bond coupons,
- harvested farm crops,
- livestock on hand (less basic herd),
- accounts receivable of a taxpayer who reported on a cash basis,
- dividends declared before the date of death and unpaid at the date of death.

Rights or Things That Relate to Employment

- unpaid salary or wages,
- unpaid commissions,
- unpaid Unemployment Insurance benefits,
- unpaid Canada or Quebec Pension Plan benefits,
- unpaid vacation pay.

} If owing at date of death but pertaining to pay periods completed prior to date of death.

The following income items are not considered rights or things:

- eligible capital property,
- resource properties,
- land inventory, and
- any amount that accrues periodically.

Obtain Interpretation Bulletins IT-212R2, *Income of Deceased Persons – Rights or Things*, IT-234, *Income of Deceased Persons – Farm Crops* and IT-427, *Livestock of Farmers* for more details.

The representative of the deceased may elect to file a separate return which would include only the value of rights or things in income. The filing date for this return is explained at the beginning of this Guide under "Filing of Returns".

If this election is made, amounts reported on this return are excluded from the ordinary return. Prepare the separate return as though it was the return of another person. For a detailed description of the allowable deductions and amounts that may be claimed on the *Rights or Things Return* see item 2 "Allowable deductions and tax credits for elective returns" discussed below.

Note: The representative may revoke this election by filing a written notice of revocation within one year from the date of death of the taxpayer or within 90 days after the mailing of any Notice of Assessment of tax for the year of death, whichever is later.

Where rights or things that would otherwise be included in the income of the deceased are transferred to a beneficiary within the time limit for filing a separate return, the value of the rights or things transferred will be excluded from income of the deceased. The value to be included in the income of the beneficiary upon realization or disposition of the right or thing will be the amount eventually received for the right or thing, minus

- both its cost to the deceased (to the extent it was not deducted in computing the income of the deceased in any prior taxation year), and
- any expenses the beneficiary incurred to acquire the property.

2. Allowable deductions and tax credits for elective returns

As indicated at the beginning of this Guide under the "Filing of Returns" section, the representative of the deceased taxpayer may, by making elections applicable to specific types of income received, file up to four separate T1 income tax returns for the year of death. The claims that may be made on each of the returns are as follows:

(1) Certain amounts used to calculate non-refundable tax credits claimed on the ordinary return for the year of death may also be claimed on each of the elective returns. They include

- basic personal amount,
- age amount,
- married amount,
- amounts for dependent children, and
- additional personal amounts.

(2) Certain tax credits may be divided and claimed on any of the returns regardless of the type of income reported on the return. The total credits claimed may not exceed the amount that could be claimed if only the ordinary return were filed with all the income reported on it. These are

- disability amount for self,
- disability amount for dependants other than spouse,
- tuition fees for self,
- education amount for self,
- tuition fee and education amount transferred from child,
- medical expenses,
- charitable donations, and
- gifts to Canada, a province or gifts of cultural property.

To arrive at the allowable portion of medical expenses for tax credit purposes,

reduce the total medical expenses by $1,500 or three per cent of the total net income reported on all returns, whichever is less.

Charitable donations claimed on any return cannot exceed 20 per cent of the net income reported on **that** return.

(3) The following deductions from net income may be claimed only on those returns on which the related income has been reported. These are

- Canada or Quebec Pension Plan contributions,
- Unemployment Insurance premiums,
- eligible pension income amount,
- employee home relocation loan deduction,
- stock option and shares deduction,
- unemployment insurance benefit repayment payable.

Note: Some provisions apply only to the ordinary return of the deceased, and do not apply to elective returns. These include

- amounts transferred from spouse,
- capital gains deduction,
- child care expenses,
- losses from other years,
- northern residents deductions, and
- withdrawals from the accumulated averaging amount.

PART III
DEEMED DISPOSITION OF CAPITAL PROPERTY AT DEATH

1. General

If the deceased owned capital property, he or she is deemed to have disposed of it immediately before death. This deemed disposition may result in

- a taxable capital gain, or
- an allowable capital loss

and in the case of depreciable properties

- a recapture of capital cost allowance, or
- a terminal loss.

New for 1988
For 1988 the inclusion rate to be used to calculate a taxable capital gain or allowable capital loss has been changed from one-half to two-thirds of the capital gain or loss.

For certain motor vehicles a recapture of capital cost allowance is not required to be included in income and a terminal loss is not deductible from income. Refer to Chapters 4 and 6 of the *1988 Business and Professional Income Tax Guide* for further information.

Note: Capital cost allowance on depreciable property **must not** be claimed in the year of death.

There are four amounts associated with the value of the property that are required to determine the gain or loss, as well as a recapture of capital cost allowance at the date of death.

These four amounts are

- for depreciable property the capital cost of the property, which usually means the actual cost plus the cost of additions and improvements. For other capital property the adjusted cost base will be required, which usually means the actual cost plus or minus specific tax adjustments,
- the undepreciated capital cost, which is the capital cost of the depreciable property less capital cost allowance previously claimed,
- the Valuation Day (V-Day) value, which is the fair market value of the property on valuation day. (For publicly traded shares the V-Day is December 22, 1971, and for all other assets is December 31, 1971. If the deceased person has not previously made the "V-Day" election, the representative may do so when the ordinary return is submitted.)
- the proceeds of disposition, which are deemed to have been received for an amount equal to the fair market value of the property at the time of death.

Refer to the *1988 Capital Gains Tax Guide* for details regarding the capital gains deduction. If allowable capital losses incurred are more than taxable capital gains, refer to Part IV of this Guide.

2. Depreciable property of a prescribed class

(1) Deceased's deemed disposition

Form T2086, *Capital Dispositions Supplementary Schedule, re: Depreciable Property upon the Death of a Taxpayer,* may be of assistance.

Where the taxpayer owned depreciable property at the time of death, he or she is deemed to have disposed of it immediately before death and to have received proceeds of an amount that is halfway between its fair market value at the time of death and the undepreciated capital cost at the time of death.

Example

Undepreciated capital cost at death	$30,000
Fair market value at death	$42,000

Deemed proceeds of disposition:

$$= \frac{\text{FMV} + \text{UCC}}{2}$$

$$= \frac{\$42{,}000 + \$30{,}000)}{2}$$

$$= \$36{,}000$$

Where the deemed proceeds of disposition are more than the capital cost, a capital gain will result. The taxable capital gain must be reported in the deceased's ordinary return. The deemed disposition may also produce a recapture of capital cost allowance claimed in previous years. Any recapture must be included as income in the deceased's ordinary return.

(2) Beneficiary's deemed cost

The cost of depreciable property to a beneficiary is deemed to be equal to:

$$\frac{\text{Fair market value of the particular depreciable property at time of death}}{\text{Fair market value of all depreciable property of that prescribed class at time of death}} \times \text{Amount of the proceeds deemed to have been received by the deceased for all depreciable property of that prescribed class}$$

Where the above calculation produces a cost that is less than the capital cost to the deceased, the capital cost to the beneficiary will be an amount equal to the capital cost to the deceased, and the excess is deemed to have been allowed as a capital cost allowance to the beneficiary.

The effect of the above is that recapture of CCA and terminal losses are reduced for the deceased below what they would have been if the property was disposed of at its fair market value during his or her life. These reductions are passed on to the beneficiary who realizes them when the property is disposed of.

(3) Transfer to spouse or spouse trust

If depreciable property of a prescribed class is passed to the spouse or a spouse trust, the deceased is deemed to have received proceeds and the spouse or spouse trust acquired at a cost, equal to:

$$\frac{\text{Fair market value of the particular property immediately before death}}{\text{Fair market value of all property of that class immediately before death}} \times \text{Undepreciated capital cost to the deceased of all property of that class immediately before death}$$

The property is consequently transferred or "rolled over" to the spouse or spouse trust without giving rise to any recapture of capital cost allowance, terminal loss or any capital gain or loss. The spouse or spouse trust computes future capital cost allowances based on the undepreciated capital cost of the property to the deceased.

If the property's cost, computed as indicated above, to the spouse or spouse trust is less than the capital cost to the deceased, the cost to the spouse or spouse trust is deemed to be equal to the capital cost to the deceased. The excess is deemed to have been allowed as capital cost allowance to the spouse or spouse trust.

The effect of the above is that any accrued capital gains or losses, recapture of CCA and terminal losses are deferred until the time of actual disposition by the spouse or spouse trust or until the death of the spouse, whichever comes first.

The representative may elect not to have the rollover provisions apply and instead use the disposition rules explained in items 2(1) and 2(2) above. For additional details obtain Interpretation Bulletin IT-305R3, *Establishment of Testamentary Spouse Trusts*.

Depreciable farm property of a deceased taxpayer that is transferred to his or her child may also be rolled over at its undepreciated capital cost. Refer to Part III, item 3(3) of this Guide.

(4) Transitional rules

Certain transitional rules provide for an adjustment to the deceased's deemed

proceeds of disposition in order to prevent taxing any capital gain that accrued on property before December 31, 1971 (Valuation Day).

Where the following situation prevails:

- the depreciable property was owned by the deceased on December 31, 1971,
- the capital cost of the property to the deceased was less than the fair market value on Valuation Day, and
- the capital cost to the deceased was less than the "proceeds of disposition otherwise determined" under item 2(1) above,

the transitional rules specify that the deemed proceeds of disposition is the amount by which the total of:

- the capital cost of the property to the deceased,

plus

- the amount, if any, by which the deceased's proceeds of disposition, determined as in item 2(1) above

exceed

- the fair market value of the property on Valuation Day.

Example — Property acquired before valuation day

Fair market value on Valuation Day	\$80,000
Fair market value at date of death	\$100,000
Capital cost	74,000
Undepreciated capital cost	66,000

Deemed proceeds of disposition as determined in item 2(1) above

$$\frac{(100{,}000 + 66{,}000)}{2} = \$83{,}000$$

Deemed proceeds of disposition as provided by the transitional rules equals \$74,000 + (\$83,000 – \$80,000) = \$77,000.

As a result, a capital gain of \$3,000 (\$77,000 – \$74,000) with a recapture of \$8,000 (\$74,000 – \$66,000) must be reported on the deceased's return.

These calculations may be completed on form T2086, *Capital Dispositions Supplementary Schedule, re: Depreciable Property upon the Death of a Taxpayer.*

If depreciable property owned on December 31, 1971 is transferred to a spouse, spouse trust or child the transitional rules are not applicable when determining the proceeds of dispositon for the deceased and the acquisition cost to the spouse, spouse trust or child. Follow the instructions in Part III, item 2(3) for transfers to spouse or spouse trust and Part III, item 3(3) for transfers of depreciable farm property to the deceased's child. At the time the spouse, spouse trust or child subsequently disposes of the property the transitional rules will then apply as if the spouse, spouse trust or child had acquired the property before 1972 and owned it from December 31, 1971 until that time.

3. Other capital property

Other capital property, such as disposition of shares of a small business corporation, is deemed to be disposed of at its fair market value at the time of death. The

cost of the property to the beneficiary is deemed to be the same amount as the deemed proceeds. If farm property is passed to a child, grandchild or great-grandchild, as a result of death, the proceeds must be calculated as explained in Part III, item 3(3) of this Guide.

> **New for 1988**
> If qualified small business corporation shares were disposed of after June 17, 1987 and in the year of death or in a preceding year a net taxable capital gain was realized, a special increase in the capital gains exemption is provided. Refer to the *1988 Capital Gains Tax Guide* for the calculation of the capital gains deduction.

(1) Transfer to spouse or spouse trust

When capital property is transferred to the spouse or a spouse trust the proceeds of the deemed dispositions are equal to the adjusted cost base to the taxpayer of the property immediately before death. The spouse or spouse trust is also deemed to receive the property at the adjusted cost base.

(2) Transitional rules

The cost to the deceased of capital property that he or she owned on December 31, 1971 (other than depreciable property or a partnership interest) can be calculated under the median amount rule unless the representative elects to establish the cost for all such property to be its fair market value on Valuation Day. However, if the deceased taxpayer has disposed of any such property during his or her lifetime and a gain or loss resulted, the cost basis used in the first return in which such a disposition was reported must also be used by the representative. Obtain Interpretation Bulletins IT-84, *Capital Property Owned on December 31, 1971 – Median Rule (Tax-Free Zone)*, and IT-139R, *Capital Property Owned on December 31, 1971 – Fair Market Value*, that discuss the median rule approach and the fair market value approach respectively.

Capital gains and losses arising from the deemed disposition of such other capital property must be reported or claimed on the deceased's ordinary return. Refer to the *1988 Capital Gains Tax Guide* for details regarding the capital gains deduction. Where allowable capital losses are incurred, refer to the information on capital losses in Part III, items 1 and 2 of this Guide for more detail.

(3) Disposition of farm property by a farmer to a child

The meaning of "child" includes grandchildren and great-grandchildren, as well as a child of the taxpayer's spouse and effective in 1985, a spouse of the child of the taxpayer. For purposes of the transfer rules, the child relationship must exist at the time of the transfer. The meaning of "child" also includes a person who, at any time while he or she was under 19 years of age, was in the deceased's custody and control and was wholly dependent on the deceased for support.

A taxpayer is permitted to pass a family farm (depreciable property and land) to his or her children on death without the consequences of a deemed realization if the following conditions are present:

- the property was used in the business of farming immediately before the taxpayer's death by the taxpayer, the spouse of the taxpayer or any of the taxpayer's children,

- the child was resident in Canada immediately before the taxpayer's death, and
- it can be shown that the property became vested indefeasibly in that child within 36 months of the death. If additional time is needed to prove that vesting occurred, the representative may request an extension by writing to the Minister. This request must be made within 36 months after the date of death.

The proceeds of the deemed disposition of the farm property may be calculated as follows:

(a) for depreciable property of a prescribed class:

$$\frac{\text{Fair market value of the particular property immediately before death}}{\text{Fair market value of all property of that class immediately before death}} \times \text{Undepreciated capital cost to the taxpayer of all property of that class immediately before death}$$

(b) for land:

the adjusted cost base to the taxpayer of the property immediately before death.

As a consequence, no capital gain, capital loss, recapture of capital cost allowance or terminal loss arises. The cost of the property to the child is deemed to be an amount equal to the deceased's deemed proceeds of disposition.

An election may be made by the representative in the ordinary return of the deceased, which replaces the rollover provisions by alternative rules. Under these alternative rules the properties may be transferred at any amount elected; however, the amount is subject to certain restrictions. The elected amount must be between the undepreciated capital cost and the fair market value for depreciable property or, in the case of land, between the adjusted cost base and the fair market value immediately before the death of the taxpayer. If there is more than one property in a class, the undepreciated capital cost must be allocated for each property concerned.

The above set of rules relating to land also apply where a share of the capital stock of a family farm corporation or an interest in a family farm partnership has been transferred to the deceased taxpayer's child.

Where the child is deemed to receive any depreciable property of a prescribed class at a cost less than the capital cost to the deceased, the cost to the child is deemed to be equal to the capital cost to the deceased. Any excess is deemed to have been allowed as capital cost allowance to the child.

Similar provisions of the Act apply when transferring farm property in Canada to a spouse trust created by a will, or under an inter vivos transfer first for the benefit of the spouse and then, upon the death of the spouse, for the benefit of the taxpayer's child or children. Where a child who has received farm property either directly upon the death of the taxpayer or upon the death of the taxpayer's spouse through an intervening testamentary or inter vivos spouse trust dies before the parent, such property may be distributed to the parent in the same manner as above. Contact the local district office if further details are needed in this respect. Interpretation Bulletin IT-349R2, *Transfer of Farm Property to Child on Death*, may also be of some assistance.

(4) Eligible capital property

This type of property consists of goodwill and other "nothings" acquired after 1971 to gain or produce income from a business. Where upon death an eligible capital property of the deceased is acquired by a person, other than a spouse or a controlled corporation that carries on the deceased's business, the deceased is deemed to dispose of eligible capital property immediately before his or her death for an amount equal to twice the cumulative eligible capital at that time. As a result of the deemed disposition the cumulative eligible capital will be reduced to nil and no amount is included in or deductible from the income of the deceased. Since there is a nil balance in the deceased's cumulative eligible capital account the deduction that is normally permitted when a taxpayer ceased to carry on a business would not apply.

If the spouse or a controlled corporation carries on the business of the deceased then the value of eligible capital property is the same amount as the cumulative eligible capital at the time of the deceased's death. As a result of this no amount is included in the income of the deceased.

If a situation occurs where the eligible capital property does not pass to any person upon the death of the taxpayer then the deceased taxpayer would be considered to have ceased carrying on the business when he or she died. In this situation a deduction of the cumulative eligible capital account, that is normally permitted when a taxpayer ceases to carry on a business, would apply.

New for 1988
For fiscal periods beginning after December 31, 1987:

- the ratio used to calculate the deemed proceeds of disposition of the eligible capital property has been changed from twice the cumulative eligible capital to 4/3 of the cumulative eligible capital;
- a portion of the negative balance in the cumulative eligible capital may be treated as a taxable capital gain, for purposes of the lifetime capital gains deduction;
- the maximum annual deduction of the cumulative eligible capital account has been reduced from 10% to 7%.

For additional information refer to Chapter 7 in the *1988 Business and Professional Income Tax Guide* and obtain Interpretation Bulletin IT-344R, *Eligible Capital Property – Deceased Persons*.

(5) Resource property or land inventory

Where an individual held Canadian or foreign resource property or held land in the inventory of a business at the time of death, special rules apply to the deemed disposition of such property. Obtain Interpretation Bulletin IT-329R, *Income of Deceased Persons – Resource Properties*, for more details.

PART IV
NET CAPITAL LOSSES

1. Net capital losses in the year of death

A capital loss may be incurred in the year of death as a result of a disposition (including a deemed disposition) of capital property (excluding depreciable property or most personal-use property such as a principal residence) owned by the deceased taxpayer before death.

Where a taxpayer's allowable capital losses in the year of death exceed the taxable capital gains in the same year, the excess may be applied as explained below.

The net capital loss may be applied against the taxable capital gains of the three immediately preceding years. Any remaining net capital losses must be reduced by the deceased's lifetime capital gains deduction claimed to date. The balance of net capital losses remaining can then be applied in full to reduce other income in either the year of death, the immediately preceding year or a portion may be deductible in each year.

In some situations the representative may decide not to apply the net capital loss against the taxable capital gains of the three immediately preceding years. If this is the case the representative would reduce the net capital loss by the deceased's lifetime capital gains deduction claimed to date and the balance of the net capital loss would be applied in full to reduce other income in either the year of death, the immediately preceding year or a portion may be deductible in each year.

New for 1988
The taxable portion of capital gains and the allowable portion of capital losses has increased from one-half to two-thirds in 1988. As a result, a 1988 net capital loss which had been calculated at two-thirds requires an adjustment when it is carried back to a prior year. Likewise, a prior year net capital loss requires adjustment when it is applied to 1988.

The net capital losses are adjusted as follows:

- if prior year net capital losses are applied against net taxable capital gains in 1988 (multiply the loss by 1.3333) or
- if a 1988 net capital loss is carried back to 1985, 1986 or 1987 (reduce the loss to .75 of the total).

In both situations, the product obtained is the **adjusted net capital loss.**

If the taxpayer, who died in 1988, incurred a net capital loss in that year and it was decided to apply this loss to a taxable capital gain in any of the prior three years, the maximum amount deductible in each year is the lesser of:

- net capital loss × .75 = **adjusted net capital loss** in 1988, and
- net taxable capital gain in the particular prior year.

If any balance remains after applying the maximum amount deductible, or any portion thereof, in any of the prior three years, this amount must be readjusted to reflect the 1988 net capital loss ratio. This readjusted amount of net capital loss may

be used to offset other income in the year of death, in the preceding year or both. The readjusted amount and the maximum deduction from other income is determined by applying the following:

• unapplied **adjusted net capital loss**		× 1.333 =	balance of the 1988 net capital loss
• balance of the 1988 net capital loss	−	the deceased's lifetime capital gains deduction claimed to date =	the amount deductible against other income in the year of death, the preceding year or both.

Example

Year of death	1988
Net capital loss in 1988	$1,800
Net taxable capital gain in 1987	$300
Lifetime capital gains deduction claimed to date	nil

The maximum amount of the 1988 net capital loss that may be applied against net taxable capital gains in 1987 is the lesser of:

- $1,800 × .75 = $1,350 **(adjusted net capital loss)**
- $300

The maximum amount is $300 which is the net taxable capital gain for 1987.

$1,350	**adjusted net capital loss**
− 300	maximum to be applied to 1987
$1,050	unapplied **adjusted net capital loss**

In order to deduct the unapplied 1988 net capital loss against other income for 1988, 1987 or a portion on both returns, the unapplied adjusted net capital loss must be converted to the 1988 ratio.

$1,050 × 1.333 = $1,400 (Amount to be applied against other income)

To request an adjustment to a return for the prior year complete form T1A *Request for Loss Carry-Back* available from any district office.

2. Net capital losses prior to the year of death

Net capital losses incurred before the year of death and not claimed in a previous year must be multiplied by the adjustment factor for the year of death (for 1988 the factor is 1.333) and the adjusted net capital loss may be applied against net taxable capital gains in the year of death. Any remaining unused losses are then readjusted by multiplying such balance by the factor for the year in which such losses were incurred (for all pre-1988 years the factor is .75) and the readjusted balance, reduced by the total capital gains deductions claimed in any year, may be applied to reduce taxable income in either the year of death or the immediately previous year, or a portion may be deducted in each year. The above calculations are broken down as follows:

If the year of death is 1988, the amount of net capital losses of prior years that may be applied against the net taxable capital gains for that year may be determined by applying the lesser of:

- unapplied net capital loss of prior years × 1.333 = the **adjusted net capital loss** at the 1988 ratio.

  and
- net taxable capital gain in the year of death.

If there is any balance remaining after deducting the adjusted net capital loss, the excess must be readjusted by multiplying it by the adjustment factor for the year in which the loss was incurred. This readjusted amount of net capital loss may be used to offset other income in the year of death, in the preceding year or both. The readjusted amount and the maximum deduction from other income is determined by applying the following:

- unapplied **adjusted net capital loss** × .75 = balance of the net capital loss of prior years
- balance of the net capital loss of prior years − the deceased's lifetime capital gains deduction claimed to date = the amount deductible against other income in the year of death, the preceding year or both.

Example 1

Year of death	1988
Net capital loss in 1986 (the loss year)	$10,000
Net taxable capital gain for year of death	$3,000
Total capital gains deduction claimed in prior years	$4,000

The maximum amount of the prior year net capital loss that may be applied against net taxable capital gains in 1988 is the lesser of:

- $10,000 × 1.333 = $13,330, and
- $3,000

The maximum amount is $3,000 which is the net taxable capital gain in 1988.

$13,330	**adjusted net capital loss**
−3,300	maximum to be applied in 1988
$10,330	(unapplied **adjusted net capital loss**)

The amount of the unapplied net capital loss that may be applied against other income in 1988, 1987 or a portion on both returns is calculated as follows:

- $10,330 × .75 = $7,747.50
- $7,747.50 − $4,000 = $3,747.50 (amount to be applied against other income in the year of death, the preceding year, or any portion in both)

Example 2

Year of death	1988
Net capital loss in 1987 (the loss year)	$200
Net taxable capital gains for year of death	$300
Total capital gains deductions claimed in prior years	$50

The maximum amount of the 1987 net capital loss that may be applied against taxable capital gains in 1988 is the lesser of:

- $200 × 1.333 = $267.00, and

• $300

$300.00	net taxable capital gains in 1988
−267.00	maximum to be applied in 1988
$33.00	remaining net taxable capital gains in 1988

In this situation the full loss is applied to reduce the net taxable capital gains.

PART V
OTHER

1. Spouse trust

A spouse trust is a trust created by the terms of a taxpayer's will. The Department also considers a trust to be created by the terms of the will if it is created by a disclaimer, or by an order of a court according to any law of a province providing for the relief or support of dependants. It is required that the spouse receives **all of the income** of the trust that arises during the spouse's lifetime, and no person except the spouse can obtain or use any of the income or capital while the spouse is alive. For example, if benefits to the spouse cease upon remarriage, the trust would not qualify as a spouse trust.

A trust may qualify as a spouse trust even though the deceased's debts, death taxes and income taxes are payable out of property that otherwise would form part of the trust. The trustee, may decide to appoint sufficient assets to cover payment of these debts by listing designated assets, the value of which is more than the debts, in the deceased taxpayer's return. The appointed property is not subject to the roll-over provisions, but the trust qualifies as a spouse's trust in respect of the remaining property. In this situation, the deadline for filing the deceased's return for the year of death is extended to 18 months after the date of death.

A trust will not be disqualified in circumstances where dividends excluded from trust income by virtue of section 83 of the Income Tax Act are treated as capital receipts and distributed (after the deceased's death) to beneficiaries other than the spouse. For more details, obtain Interpretation Bulletin IT-207R, *Tainted Spouse Trusts*.

If a spouse trust is to qualify as such, the following further conditions must be met:

- the taxpayer must have been resident in Canada immediately before death,
- the trust must be resident in Canada immediately after the time the property vested indefeasibly in the trust, and
- it must be shown within 36 months of the death of the taxpayer that the property has become vested indefeasibly in the spouse or spouse trust. If additional time is needed, the representative has the option of requesting in writing to the Minister for an extension. This request must be made within 36 months after the date of death. Refer to Interpretation Bulletin IT-449, *Meaning of "vested indefeasibly"* for more information concerning property that has vested indefeasibly.

A renunciation by a beneficiary under a will or on an intestacy makes possible the transfer of property to a spouse trust. A renunciation involves an outright refusal to accept a gift, share or interest under a will, without stipulating as to how the repre-

sentative should distribute the disclaimed property. This disclaimer must be made within the time stipulated above for indefeasible vesting of property. For a more detailed discussion on spouse trusts, refer to Interpretation Bulletin IT-305R3, *Establishment of Testamentary Spouse Trusts*.

2. Disposition of property by representative

Where, in the course of administering the estate of a deceased taxpayer, the representative has, within the first taxation year of the estate,

(a) disposed of capital property of the estate that resulted in an excess of capital losses over capital gains, or

(b) disposed of all the depreciable property of a prescribed class of the estate that resulted in a terminal loss in that class at the end of the first taxation year of the estate,

the representative may elect to deem such losses to have been incurred by the deceased taxpayer from the disposition of property in the year in which he or she died rather than by the estate. In the case of (b) above, the elected amount cannot exceed the amount that would have been the total of the non-capital loss and the farm loss, if any, of the estate for its first taxation year in the absence of the election. In order for the representative to make this election certain information, as outlined in Section 1000 of Part X of the Income Tax Regulations, must be submitted to the Department. Contact any district office to obtain details on what information is required.

The representative must file this election and an amended return for the deceased taxpayer for the year of death by the later of:

(a) the last day the representative is required or has elected to file for the year of death, and

(b) the day the estate's return must be filed for its first taxation year.

The election and the amended return have no effect on the return of the deceased taxpayer for any year preceding the year of death. The estate does not claim any of the elected losses. Refer to the *Guide to the 1988 T3 Trust Return* for filing requirements of T3 estate returns.

3. Charitable donations or gifts by will

If, by will, a deceased person has made a charitable donation, a gift to Her Majesty or a cultural gift (supported by proper receipts), the donation or gift is considered to be made by the taxpayer in the year of death and the deductible amount may be claimed as a tax credit. Note that donations made in the year of death may be carried back one year. In no case, however, may the amount in respect of charitable donations exceed 20% of the taxpayer's net income for the year in question when determing the amount to be used in the calculation of the tax credit. On the other hand, gifts to her Majesty and cultural gifts are not so restricted.

Where the charitable donation or gift to her Majesty consists of capital property that had a fair market value greater than the adjusted cost base to the taxpayer, the representative may designate an amount not greater than the fair market value and not less than the adjusted cost base as the amount of the gift or donation. This amount is deemed to be the deceased's proceeds of disposition of the property as well.

Where the charitable donation or gift to her Majesty consists of a work of art created by the deceased person that is property in inventory, the representative may designate the amount of the deceased person's deemed proceeds of disposition. This amount may be determined by allocating an amount not greater than the fair market value and not less than the inventory value for tax purposes of the work of art to the individual at the time of the donation. The claim must be supported by a proper receipt.

As explained in Part II, item 2 of this Guide, charitable donations, within certain limits, and gifts to the Crown may be claimed on more than one of the returns filed for the year of death.

4. Income earned after death

Income that is attributable to the period after death is reported by the estate on a T3 Trust Return. This return would report amounts assigned to beneficiaries or report income earned after death. The *Guide to the 1988 T3 Trust Return* provides additional information and may be obtained from any district office.

5. Payment of tax

For the year of death, the representative may elect on prescribed form T2075, *Election under subsection 159(5) by a Deceased Taxpayer's Legal Representative to Defer Payment of Income Tax*, to defer payment of all or any portion of the tax attributed to income from the value of rights or things at the date of death and from deemed dispositions of capital property at death. This election requires that the representative furnish security acceptable to the Minister to guarantee payment of the deferred tax in not more than ten equal consecutive annual instalments with interest at a prescribed rate. The first payment is due at the same time as the deceased taxpayer's return is due and the remaining nine (or fewer) payments are due at one-year intervals following the date the deceased taxpayer's return is due.

6. Clearance certificate

The Income Tax Act requires that every administrator or executor obtain a clearance certificate before distributing any property under their control if they wish to avoid becoming personally liable for any unpaid taxes, interest and penalties.

A request for a clearance certificate should not be made until the assessment notices for all returns filed have been received. Do not include the request with the income tax returns, as returns are sent to a taxation centre for processing while certificates are issued by district offices. It should be noted that a clearance certificate cannot be issued until all required income tax returns have been filed and assessed, and all taxes, contributions, interest and penalties have been paid or secured.

The written request for a clearance certificate must be mailed to the attention of the Business Audit Section at the district office serving the area where the representative is located. The request should identify the person(s) requesting the certificate by name, address and title (such as executor or administrator) and should indicate the full name, last address, Social Insurance Number and date of death of the deceased taxpayer.

The certificate covers the period ending with the date of death and any preceding taxation year. It does not include a clearance for any liability resulting from a trust that was, or should have been, established for the period after death. The *Guide to*

the 1988 T3 Trust Return contains more information regarding trusts, and can be obtained from any district office.

To facilitate the timely release of the clearance certificate, the following documentation should be provided together with the request:

- a copy of the will,
- a statement showing the assets of the estate at the date of death, together with the adjusted cost base and fair market value of the properties, and
- in the case of intestacy, details of the proposed distribution of the assets including the names and addresses of the beneficiaries and their relationship to the deceased.

Further details concerning a request for a clearance certificate can be found in Information Circular 82-6, *Requesting Clearance Certificate for Estates and Trusts* and Interpretation Bulletin IT-282R, *Estate or Trust Distributions – Clearance Certificates*.

NOTES