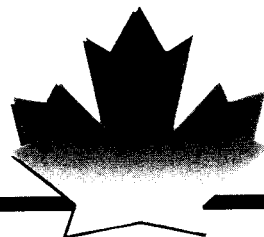




Deceased Persons Tax Guide

1989

Your Guide



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Canada

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, or contact your district office.

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INTRODUCTION

This Guide contains information of particular use to legal representatives (executor or administrator) of deceased taxpayers. Since it does not include all the information necessary to complete a tax return, it refers to the *1989 General Tax Guide* and the *1989 T1 General Income Tax Return*. If you are filing a **T1 Special return** for the deceased, you may use the general tax guide and this Guide in conjunction with the 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 deceased taxpayers. If you have received a T1 Special return on behalf of the deceased, you may use it providing the lines can accommodate the deceased's income, deductions and non-refundable tax credits. Otherwise, you should use the T1 General return.

FILING OF RETURNS

As the legal representative of a deceased taxpayer, you must file any required income tax return(s) for that person. If filing before the current year returns are available, you may use the prior year's T1 General return and change the year in the top right-hand corner of page 1. Depending upon the various sources of the deceased's income and whether certain elective provisions of the *Income Tax Act* are exercised, you may file as many as four separate income tax returns for the year of death, as outlined below:

a) Ordinary Return (150(I)(b))

- 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. You must file this return by either 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 from which testamentary debts must be paid, the deadline for filing the deceased's return may be extended to 18 months after the date of death.

Interest on arrears begins to accrue from six months after the date of death or April 30 of the year following the year of death, whichever is later.

Note:

When the ordinary return for a deceased taxpayer is filed late, it is subject to a penalty of 5% of the tax owed on the filing deadline, plus 1% for each complete month it is late up to a maximum period of 12 months.

b) Elective Returns

Note:

You must identify all elective returns by entering the number of the section or subsection of the Act at the top of page 1 of the return.

- i) **Separate return for income from partnerships or proprietorships (150(4))**
 - The *Income Tax Act* provides special rules when the deceased was 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 partnership or proprietorship 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 may 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.

Interest on arrears begins to accrue from six months after the date of death or April 30 of the year following the year of death, whichever is later.

ii) Separate return for trust income (104(23)(d))

- Where the deceased was an income beneficiary of a testamentary trust with a fiscal period other than the calendar year, you may file a separate return. 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.

Interest on arrears begins to accrue from six months after the date of death or April 30 of the year following the year of death, whichever is later.

iii) Separate return for rights or things (70(2))

- As legal representative for the deceased, you 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. For further details on Rights or Things, refer to Part II, item 1 of this Guide.

Interest on arrears begins to accrue from one year after the date of death, or 90 days after the mailing of any notice of assessment of tax for the ordinary return, whichever is later.

Note:

If a taxpayer died before the immediately preceding year's return was filed, the filing deadline for that 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, ensure all the information at the top of the return is accurate. The name of the taxpayer should be preceded by "The Estate of the Late. . ." and the address should be that of the executor or administrator. The reference to province or territory of residence on December 31 refers to the deceased's residence at the date of death. The date of death should be entered on the appropriate line.

2. Calculation of total income

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

In some instances, such as in the case of an early-filed 1990 return, it may be necessary to contact the payer of the sources of income in order to obtain the following information slips:

- T4 — *Statement of Remuneration Paid*
- T4A — *Statement of Pension, Retirement, Annuity and Other Income*
- T4A(P) — *Statement of Canada Pension Plan Benefits*
- T4A(OAS) — *Statement of Old Age Security*
- T4U — *Statement of Unemployment Insurance Benefits Paid*
- T5 — *Return of Investment Income*
- T600 — *Ownership Certificate*
- TFA1 — *Statement of Family Allowances*

If the payer is unable to supply an information slip, a confirmation by letter or some other statement of income will be acceptable. If such confirmation or information slip 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 of explanation to the return stating the estimated amounts. Be sure to give the employer's name and address, and to attach copies of pay stubs available.

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 during the period for which the amount was payable. This rule does not apply to amounts receivable but not payable on or before the date of death. For example, it does not apply to income from annuity contracts deemed to have been disposed of on death. For additional information on income receivable on or before the date of death, consult Part II of this Guide.

Any amount that is not actually received before the taxpayer's death but is deemed to have accrued to the date of death is included in the ordinary return for the year of death. For further details obtain Interpretation Bulletin IT-210R, *Income of Deceased Persons — Periodic Payments*.

Certain income received after the date of death may be reported on the ordinary return for the year of death or 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.

The line numbers listed below refer to lines on the General and Special income tax returns. 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 including amounts accrued from the beginning of the pay period in which the employee died to the date of death.

Lines 113 to 115 — Pension income

Include all amounts of pension or superannuation income received for the period from January 1 to the date of death. Do not include the "Net Federal Supplements Paid" as shown in Box (H) of the T4A(OAS) slip.

Lump sum payments paid out of a pension fund or plan as a result of death, including a death benefit paid under the Canada or Quebec Pension Plans, are normally taxable in the hands of the recipient. The beneficiary may be either the spouse, the children, or the estate. For information on how to report various lump sum payments and death benefits, refer to line 114 and item "C" under line 130 of the 1989 *General Tax Guide*, as well as to Interpretation Bulletins IT-301, *Death Benefits — Qualifying Payments* and IT-508, *Death Benefits — Calculation*.

Note:

An estate that is created after the death of a taxpayer will require the filing of a T3 trust income tax return and information return. This form is available at any district taxation office.

New for 1989

If the total "net income before adjustments" from line 234 on all returns for the year of death is greater than \$50,000, you may have to repay a portion of the Old Age Security benefits that the deceased received. For further information, see line 235 of the 1989 *General Tax Guide*.

Line 118 — Family allowance payments

If the deceased was married from January 1, 1989, until the date of death, or was separated as a result of a marriage breakdown for a period of less than 90 days starting in 1989, the spouse with the higher net income (before including family allowance and deducting child care expenses and social benefits repayments) must report the family allowance received in the year up to the date of death.

If the deceased married in 1989 or was separated as a result of a marriage breakdown for a period of 90 days or more starting in the year of death,

- the family allowance payments for all months at the end of which the couple was separated or not married must be reported by the person who received the family allowance cheques, and
- the family allowance payments for all other months, up to the date of death, must be reported by the spouse with the higher net income for the year (before including family allowance and deducting child care expenses and social benefits repayments).

Note:

Whoever claims an equivalent to married amount for a dependant must report the family allowances for the entire year with respect to that particular dependant, regardless of who actually received the payments.

New for 1989

If the total "net income before adjustments" from line 234 on all returns for the year of death is greater than \$50,000, you may have to repay a portion of the family allowance benefits that the deceased received. For further information, refer to line 235 of the *1989 General Tax Guide*.

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. 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. 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 was an annuitant under an unmatured registered retirement savings plan, and the deceased's spouse is entitled, as beneficiary under the plan, to receive the amount accumulated in the 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 considered their income.

You must include in the income of the deceased the difference between the fair market value of the property in an RRSP, at the time of death, and the amounts designated as "refund of premiums" to the spouse or dependent children. Where an amount is paid out of an RRSP to the estate of the deceased, the legal 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 *1989 Pension and RRSP Tax Guide*.

Lines 130 to 143 — Other types of income

These 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 *1989 General Tax Guide*. If the deceased owned capital property at the date of death, refer to 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, the *Income Tax Act* provides 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 of the *Income Tax Act* 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 the uncollected proceeds is transferred or distributed to the spouse or spouse trust, and the legal representative and the beneficiary of the transfer jointly make an election, on the prescribed form, in respect of such property. If the right to receive such uncollected proceeds is not transferred or distributed to the spouse or spouse trust, the reserve may not be claimed. To make such a transfer, you must fill out and submit 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, 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.

Where a capital gains reserve, arising from a disposition of property occurring after 1984, is reported by the spouse, spouse trust or by the deceased, this amount would qualify for purposes of the capital gains deduction for 1988 and subsequent taxation years.

3. Lines 207 to 232 — Deductions from total income

Follow the instructions in the *1989 General Tax Guide*.

4. Line 237 — Accumulated forward averaging amount withdrawal

There are various options available for an individual with accumulated forward averaged amounts who died in 1989. If the legal representative decides to do nothing with respect to the amounts previously forward averaged, there will be no

further tax consequences. On the other hand, you may elect to bring back into the income of the deceased, 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 using only a portion of the accumulated forward averaged amounts, there will be no further tax consequences on the balance, unless you elect to have the three year carryback provision apply. 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 the return for the year of death is required to be filed.

5. Deductions from net income

Line 253 — Net 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 *1989 General Tax Guide* for the remaining deductions from net income.

6. Calculation of total non-refundable tax credits

These credits are calculated in the section entitled "Calculation of Total Non-Refundable Tax Credits" on page 2 of the *1989 T1 General Income Tax Return* and are explained in detail in the *1989 General Tax Guide*.

Lines 300 and 301 — Personal amounts

Unless the deceased resided outside Canada during the period from January 1 until the date of death, personal amounts are not prorated to the date of death. The maximum basic personal amount of \$6,066 may be claimed and, if the deceased had reached the age of 65, the maximum age amount of \$3,272 may also be claimed.

If the deceased immigrated to or emigrated from Canada before the date of death, consult the *1989 Tax Guide for Emigrants* or the *1989 Tax Guide for New Canadians*.

Line 303 — Married amount

You may claim the full married amount on behalf of the deceased for a spouse whose income, **for the entire year**, was not more than \$506. A partial amount may be claimed if the spouse's income, **for the entire year**, was more than \$506 but less than \$5,561. 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 deceased's death, was not in a position to support the latter. This would apply even where the income of the deceased, in the year of death, was not more than \$506. Where the surviving spouse claims the married amount, the net income of the deceased from all returns filed for the year of death must be used in the calculation of the married amount.

Note:

The income of the surviving spouse for the entire year, rather than to the date of death, must be used in calculating the married amount. If claiming amounts for dependent children and additional personal amounts, the income for the entire year must also be used in those calculations.

Lines 304 and 305 — Amounts for dependent children and additional personal amounts

Amounts for dependent children, and additional personal amounts must be claimed on Schedule 6. Only the person who must report the family allowance payments may claim the "amounts for dependent children" with respect to the child for whom the payments were received. If more than one person reports the family allowance received for a particular 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 — Pension income amount

If, prior to death, the deceased received eligible pension income, you may use the amount received in the year or \$1,000, whichever is less, to calculate this tax credit. Refer to the *1989 General Tax Guide*, which contains details on eligible and ineligible pension income, to determine the amount that may be claimed for tax credit purposes.

How to calculate the pension income amount

Complete the appropriate chart at line 314 in the *1989 General Tax Guide* to calculate the amount of the credit. Select the chart that applies to the age of the deceased on the date of death.

Lines 316 and 318 — Disability amount

An amount of \$3,272 may be claimed if the deceased had a severe impairment (mentally or physically) in 1989, and where the condition

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

Usually, you may not claim the disability amount if you or any other person claim medical expenses for a full-time attendant or full-time 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.

New for 1989

Subject to certain conditions, you may claim the disability amount and medical expenses for an attendant who, before the date of death, cared for the taxpayer in Canada in order to enable the deceased to earn income for the year. (Earned income includes income from employment, business, a training allowance under the National Training Act, a scholarship, fellowship, bursary or research grant.) For further information, refer to line 215 of the *1989 General Tax Guide*.

Note:

If the deceased would have been entitled to the disability amount, do not prorate it to the date of death. Claim the full amount.

For further information on this subject, consult the *Disability Credit* brochure and the *1989 General Tax Guide*.

Line 326 — Amounts transferred from spouse

The unused portion of certain available credit amounts, that are not required to reduce the surviving spouse's federal income tax to zero, 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 federal income tax to zero on the return of the deceased, any unused portion may be transferred to the surviving spouse.

The following credits may be transferred:

- age amount (if the spouse was 65 years of age or older);
- pension income amount;
- disability amount;
- tuition fees and education amount.

Refer to Schedule 2 in the *1989 General Tax Return* package.

Line 330 — Medical expenses

You may claim the amount of medical expenses for the deceased for any 24-month period, including the date of death, where such amounts have not previously been claimed and the total expenses were more than \$1,517 or three per cent of the net income of the deceased, whichever is less. To make such a claim, complete Schedule 4 which is found in the *1989 T1 General Tax Return* package and attach it and all receipts to the return.

For more details on eligible medical expenses, consult Interpretation Bulletin IT-519, *Medical Expense and Disability Tax Credits*.

Line 340 — Charitable donations

You may claim an amount for 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 previous years, attach a note to the return indicating the year in which these donations were made and the amount carried forward. Official receipts must be filed with the return.

Charitable donations made in the year of death by a deceased 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 deceased made to registered

charities may be claimed in the year of death, if amounts can be established through proper receipts. Refer to line 340 of the *1989 General Tax Guide*.

Note:

The maximum you may claim for charitable donations in the return of the deceased is 20% of the net income for the year in question.

Line 342 — Gifts to Canada or to a province

You may claim an amount for gifts made to Canada, a province or to an institution in Canada for property certified by the Canadian Cultural Property Export Review Board. Refer to Part V, item 3 "Charitable Donations or Gifts by Will," of this Guide for further details.

7. Summary of tax and credits

Refer to the Tax Tables in the *1989 General Tax Guide*. Read the instructions carefully to determine which of the tables may be used. Otherwise, you must complete a Schedule 1, *Detailed Tax Calculation*. All items described under the heading "Summary of Tax and Credits" in the *1989 General Tax Guide* are applicable in the year of death.

Note:

If the deceased had paid minimum tax in 1987 or 1988, part of that tax may be deducted from the 1989 taxes payable. To calculate this claim, complete Part VII of form T691, *Calculation of Minimum Tax* and attach the completed form to the deceased's return. It should be noted however, that **minimum tax is not applicable in the year of death**.

Line 446 — Federal sales tax credit

This credit may be claimed on the return of either the deceased or the surviving spouse.

Note:

The total net income of the deceased from all returns filed for the year of death must be reflected in the calculation of this credit.

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 *1989 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 deceased may have had at the time of death "rights or things" (other than any capital property) which would only have been included in income when realized or disposed of. The value of these rights or things at the date of death must be included in computing the deceased's income for the year of death.

The following are examples of rights or things:

Other Rights or Things

- uncashed matured bond coupons,
- any other bond interest accrued before the last interest payment date and not reported in previous taxation years,
- 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 benefits,
- unpaid vacation pay

if owing at date of death but pertaining to pay period completed prior to date of death.

The following income items are not considered rights or things:

- bond interest accrued between the last interest payment date before the taxpayer's death and the date of death,
- eligible capital property,
- resource properties,
- land in the inventory of the business of the deceased,
- income from an income-averaging annuity contract, and
- any amount that accrues periodically.

For more details, obtain Interpretation Bulletins IT-210R, *Income of Deceased Persons — Periodic Payments*, IT-212R2, *Income of Deceased Persons — Rights or Things*, IT-234, *Income of Deceased Persons — Farm Crops*, IT-427, *Livestock of Farmers* and Information Circular 86-6, *Basic Herds*.

As the legal representative of the deceased, you may elect to file a separate return which would include only the value of rights or things as income. Details on the filing deadline for this return are 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 non-refundable tax credits that may apply to the *Rights or Things Return*, refer to item 2 "Allowable deductions and tax credits for elective returns" discussed below.

Note:

You may revoke this election by filing a written notice of revocation, signed by the deceased's legal representative, within one year from the date of death of the taxpayer or within 90 days after the mailing of a Notice of Assessment 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 amount to be included in the income of the beneficiary upon realization or disposition of the right or thing will be the proceeds eventually received for the right or thing, minus

- 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 non-refundable tax credit amounts for elective returns

As indicated at the beginning of this Guide under the "Filing of Returns" section, the legal 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 credit amounts may be divided and claimed on any of the returns regardless of the type of income reported on the return. The total amounts 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,
 - disability amount for dependant,
 - tuition fee and education amount for the deceased,
 - tuition fee and education amount transferred from child,
 - medical expenses,
 - charitable donations, and
 - gifts to Canada, a province or an institution in Canada.

To arrive at the allowable portion of medical expenses for tax credit purposes, reduce the total medical expenses by the lesser of \$1,517 or three per cent of the total net income reported on **all** returns. The medical expenses may be claimed on any one of the returns for the year of death. 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 and amounts for non-refundable tax credits 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,
 - pension income amount,
 - employee home relocation loan deduction,
 - stock option and shares deduction,
 - social benefits repayment deduction, and
 - vow of perpetual poverty deduction.

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

The deceased is deemed to have disposed of all capital property 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.

Note:

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 1989 Business and Professional Income Tax Guide for further information.

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, minus any grant or financial assistance received from a government, municipality or other public agency for the purchase of that property. For other capital property the adjusted cost base will be required, which usually means the actual cost plus or minus specific tax adjustments provided for in the *Income Tax Act*,
- 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. The V-Day value is important only for property acquired before January 1, 1972. For publicly traded shares the V-Day is December 22, 1971, and for all other assets is December 31, 1971. If the deceased has not previously made the "V-Day" election, the legal representative may do so when the ordinary return is submitted.
- the proceeds of disposition, which are deemed to have been received. This amount is equal to the fair market value of the property at the time of death.

Note:

The taxable portion of a capital gain and the allowable portion of a capital loss is two thirds.

Refer to the 1989 *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

A) Deceased's deemed disposition

Form T2086, *Capital Dispositions Supplementary Schedule*, re: *Depreciable Property upon the Death of a Taxpayer*, may be of assistance. You will find a copy in this Guide.

All depreciable property of a prescribed class, owned by the deceased at the time of death, is deemed to have been disposed of immediately before death and the deceased is deemed 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 (UCC) at death..... \$ 30,000
Fair market value (FMV) 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 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 ordinary return.

B) Beneficiary's deemed cost

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

$\frac{\text{Fair market value of the particular depreciable property at time of death}}{\text{Fair market value of all depreciable property of that prescribed class at time of death}}$	×	Amount of the proceeds deemed to have been received by the deceased for all depreciable property of that prescribed class
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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 (CCA) 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 the life of the deceased. These reductions are passed on to the beneficiary who realizes them when the property is disposed of.

C) 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 disposed of the property and the spouse or spouse trust acquired it at a cost, equal to:

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

Consequently, the property is transferred or "rolled over" to the spouse or spouse trust without giving rise to any recapture of capital cost allowance, terminal loss, capital gain or loss for the deceased. The spouse or spouse trust calculates future capital cost allowance claims based on the undepreciated capital cost of the property to the deceased, as indicated in the above calculation.

If the property's cost, calculated as shown 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 carried forward until the time of the actual disposition by the spouse or spouse trust or until the death of the spouse, whichever comes first.

As the legal representative, you may elect not to have the rollover provisions apply and instead use the disposition rules explained in items 2 A) and 2 B) above. For additional details, obtain Interpretation Bulletin IT-305R3, *Establishment of Testamentary Spouse Trust*.

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

D) Transitional rules

Certain transitional rules provide for an adjustment to the deemed proceeds of disposition in order to prevent taxing any capital gain that accrued on property before December 31, 1971 (Valuation Day).

In the following situation:

- the depreciable property was owned by the deceased on Valuation Day,
- 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 A) above,

the transitional rules specify that the deemed proceeds of disposition are equal to:

- 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 A) above exceeds
- the fair market value of the property on Valuation Day.

For further details, where more than one capital property is deemed to have been disposed of, consult the Special Release dated September 13, 1982, for IT-217, *Capital Property Owned on December 31, 1971 — Depreciable Property*.

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 A) above

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

The deemed proceeds of disposition calculated using the transitional rules equals \$74,000 + (\$83,000 - \$80,000) = \$77,000.

The result of this calculation is a capital gain of \$3,000 (\$77,000 - \$74,000), which must be indicated on Schedule 3, and a recapture of \$8,000 (\$74,000 - \$66,000), which must be reported on the return of the deceased.

Note:

To determine the taxable capital gain in the above calculation, you must multiply the total capital gain of \$3,000 by two thirds.

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

When 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 disposition for the deceased and the acquisition cost to the spouse, spouse trust or child. Follow the instructions in Part III, item 2 C) for transfers to spouse or spouse trust and Part III, item 3 C) 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 could apply as if the spouse, spouse trust or child had acquired the property before 1972 and owned it from December 31, 1971 until the date of disposition.

3. Other capital property

Other capital property, such as shares of a small business corporation, is deemed to be disposed of at its fair market value at the date of death. The cost of the property to the beneficiary is deemed to be equal to the deemed proceeds. If farm property is passed to a child as a result of death, the proceeds must be calculated as explained in Part III, item 3 C) of this Guide.

Note:

If qualified small business corporation shares were disposed of after June 17, 1987, and a net taxable capital gain was realized in the year of death or in a preceding year, a special increase in the capital gains exemption is provided. Refer to the 1989 Capital Gains Tax Guide for the calculation of this deduction.

A) Transfer to spouse or spouse trust

When capital property is transferred to the spouse or a spouse trust, the deemed proceeds of disposition are equal to the adjusted cost base to the deceased immediately before death. Accordingly, the spouse or spouse trust is deemed to receive the property at this adjusted cost base.

Note:

As the legal representative, you may elect not to apply this rule. You must then follow the usual rules for fair market value dispositions. Consult Interpretation Bulletin IT-305R3, Establishment of Testamentary Spouse Trust.

B) Transitional rules

The cost to the deceased of capital property owned on December 31, 1971 (other than depreciable property or a partnership interest) can be calculated under the median rule unless you elect to establish the cost for all such property to be its fair market value on Valuation Day. However, if the deceased had disposed of any such property prior to the date of death and either of the valuation methods was selected, the legal representative must follow the same method for all deemed dispositions of such property in the year of death. 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*, for further details on the median rule and the fair market value approaches.

Capital gains and losses arising from the deemed disposition of such other capital property must be reported or claimed on the ordinary return. Refer to the *1989 Capital Gains Tax Guide* for details regarding the capital gains deduction. Where allowable capital losses are incurred, refer to Part III, items 1 and 2 of this Guide for more details.

C) Disposition of farm property by a farmer to a child

The meaning of "child" includes a grandchild and great-grandchild, as well as a child of the taxpayer's spouse and, effective since 1985, a spouse of the taxpayer's child. For purposes of the transfer rules, the taxpayer's relationship with the child 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 custody and control of the deceased, in law or in fact, and was wholly dependent on the deceased for support.

A taxpayer is permitted, on death, to transfer a family farm (depreciable property and land) to a child without the consequences of a deemed disposition if the following conditions are present:

- the property, located in Canada, was used in the business of farming immediately before the taxpayer's death by the taxpayer, the spouse 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, you may request an extension by writing to the Minister. This request must be made within 36 months after the date of death. For further details, refer to Interpretation Bulletin IT-449R, *Meaning of "Vested Indefeasibly"*.

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

(a) for depreciable property of a prescribed class:

Fair market value of the particular property immediately before death	×	Undepreciated capital cost to the taxpayer of all property of that prescribed class immediately before death
Fair market value of all property of that prescribed 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 for the deceased taxpayer. The cost of the property to the child is deemed to be an amount equal to the deemed proceeds of disposition of the deceased.

You may make an election 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 to each property concerned, according to the proportion calculated in item a) above.

The above election and 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 child of the deceased.

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 child or children of the deceased. 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 manner indicated in the preceding paragraphs.

Note:

The Income Tax Act extends the normal meaning of "parent", as indicated below. A parent of a taxpayer may be:

- a person of whom the taxpayer is the child, whether born within or outside marriage;
- a person who has custody and control of the taxpayer or had custody and control before the taxpayer attained the age of nineteen years and on whom the taxpayer is wholly dependent for support;
- the father or mother of the taxpayer's spouse;
- the taxpayer's mother-in-law and father-in-law; and
- for 1985 and subsequent taxation years, a person who, in law or in fact, had adopted the taxpayer.

For further information on this subject, contact any district taxation office. You can also obtain Interpretation Bulletin IT-349R2, *Intergenerational Transfers of Farm Property on Death*.

D) Eligible capital property

This type of property consists of goodwill and other "nothings" acquired after 1971 to 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 business of the deceased, the eligible capital property is deemed to have been disposed of immediately before death for an amount equal to one and one third the cumulative eligible capital at that time. As a result of the deemed disposition, no amount is included in the income of the deceased. Since there is a nil balance in the cumulative eligible capital account of the deceased, the deduction that is normally permitted when a taxpayer ceases to carry on a business would not apply.

If the spouse or a controlled corporation carries on the business of the deceased, the value of eligible capital property is the same amount as the cumulative eligible capital of the deceased at the date of death. As a result of the deemed disposition, no amount is included in the income of the deceased.

If the eligible capital property is not transferred to any person upon the death of the taxpayer, the deceased would be considered to have ceased carrying on the business at the time of death. In this situation a deduction of the cumulative eligible capital account, that is normally permitted when a taxpayer ceases to carry on a business, will apply at the date of death.

For additional information, refer to Chapter 7 in the *1989 Business and Professional Income Tax Guide* and obtain Interpretation Bulletin IT-344R, *Eligible Capital Property — Deceased Persons*.

E) Resource property or land inventory

When an individual holds Canadian or foreign resource property or holds 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 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 lifetime capital gains deduction claimed to date by the deceased. The balance of net capital losses 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 you 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, you would reduce the net capital loss by the lifetime capital gains deduction claimed to date by the deceased, 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. Since 1988, the taxable portion of capital gains and the allowable portion of capital losses has increased from one-half to two-thirds in 1989. As a result, a 1989 net capital loss which had been calculated at two-thirds requires an adjustment when it is carried back to a year prior to 1988. Likewise, a net capital loss for a year prior to 1988 requires adjustment when it is applied to 1989.

The net capital losses are adjusted as follows:

- if net capital losses for years prior to 1988 are applied against net taxable capital gains in 1989 (multiply the loss by 1.333) or

- if a 1989 net capital loss is carried back to 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 1989, 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 three previous years, the maximum amount deductible in taxation years 1986 and 1987 is the lesser of:

- net capital loss \times .75 = **adjusted net capital loss** in 1989, and
- net taxable capital gain in the particular prior year.

Note:

No adjustment has to be made before applying a 1989 net capital loss to 1988, or vice versa, since the same rate (two thirds) is used for both these taxation years.

If any balance of the adjusted net capital loss of the year of death remains after applying the maximum amount deductible, or any portion thereof, in any of the three previous years, this amount must be readjusted to reflect the 1989 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 a combination of both. The readjusted amount and the maximum deduction from other income are determined as follows:

- unapplied **adjusted net capital loss** for 1987 and 1986 \times 1.333 = balance of the 1989 net capital loss
- balance of the 1989 net capital loss $-$ lifetime capital gains deduction claimed to date by the deceased = the deductible amount against other income in the year of death, the preceding year or both

Example

Year of death	1989
Net capital loss in 1989	\$1,800
Net taxable capital gain in 1987	\$300
Lifetime capital gains deduction claimed to date	nil

The maximum amount of the 1989 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 deductible amount is \$300, which is the net taxable capital gain for 1987.

\$1,350	adjusted net capital loss
<u>– 300</u>	maximum to be applied to 1987
\$1,050	unapplied adjusted net capital loss

In order to deduct the unapplied 1989 net capital loss against other income for 1989, 1988 or a portion on both returns, the unapplied adjusted net capital loss must be converted to the 1989 ratio.

$$\$1,050 \times 1.333 = \$1,400 \text{ (Amount deductible against other income)}$$

To request an adjustment to a return for the prior year, complete form TIA, *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 prior year must be converted using the adjustment factor for the year of death (for 1989 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 the balance by the adjustment factor for the year in which the losses were incurred (for all pre-1988 years the factor is .75) and this readjusted balance is reduced by the total capital gains deductions claimed in previous years and subsequently applied to reduce taxable income in either the year of death, the immediately previous year, or a portion may be deducted in each year. The above calculations are broken down below.

Note:

Since the same rate adjustment factor of two thirds is used for taxation years 1988 and 1989, net capital losses incurred in either of these years are interchangeable and require no adjustment.

If the year of death is 1989, the amount of net capital losses of other 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 (1987 and before) × 1.333 = the **adjusted net capital loss** at the 1989 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 (for years prior to 1988, the factor is .75). 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 as follows:

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

Example 1

Year of death	1989
Net capital loss in 1986 (the loss year)	\$10,000
Net taxable capital gain in 1989 (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 1989 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 1989.

\$13,330	adjusted net capital loss
<u>– 3,000</u>	maximum to be applied in 1989
\$10,330	(unapplied adjusted net capital loss)

The amount of the unapplied net capital loss that may be applied against other income in 1989, 1988 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 a combination of both)

Example 2

Year of death	1989
Net capital loss in 1987 (the loss year)	\$200
Net taxable capital gains for 1989 (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 1989 is the lesser of:

- \$200 × 1.333 = \$267.00, and
- \$300

\$300.00	net taxable capital gains in 1989
<u>– \$267.00</u>	maximum to be applied in 1989
\$ 33.00	remaining net taxable capital gains in 1989

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

Note:

You will find further information in the 1989 Capital Gains Tax Guide, which is available from any district office.

PART V OTHER

1. Spouse trust

A spouse trust is created by the terms of a deceased'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 still qualify as a spouse trust even though the debts, death taxes and income taxes of the deceased 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 return of the deceased. The appointed property is not subject to the roll-over provisions, but the trust qualifies as a spouse trust in respect of the remaining property.

A spouse 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 taxpayer'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 also be met:

- the taxpayer and the spouse must have been resident in Canada immediately before death,
- the trust must be resident in Canada immediately after the property vested indefeasibly in the trust, and
- it must be shown within 36 months of the date of death that the property has become vested indefeasibly in the spouse or spouse trust. If additional time is needed, the legal 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-449R, *Meaning of "Vested Indefeasibly"*, for more information on this matter.

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 legal representative should distribute the disclaimed property. This disclaimer must be made within the 36-month period 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 legal representative

Where, in the course of administering the estate of a deceased taxpayer, the legal 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 legal representative may elect, in a prescribed manner and within the prescribed timeframe, to deem such losses to have been incurred by the deceased from the disposition of property in the year of death 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 legal 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 legal representative must file this election and an amended return for the deceased for the year of death by the later of:

- (a) the last day the legal 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 for any year preceding the year of death. The estate does not claim any of the elected losses. Refer to the 1989 *Guide to the T3 Trust Return* for filing requirements of T3 estate returns.

3. Charitable donations or gifts by will

When a deceased person has made, by will, 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. The amount in respect of charitable donations may not exceed 20% of the net income of the deceased for the year in question when determining the amount to be used in the calculation of the tax credit.

Note:

Gifts to Her Majesty and cultural gifts may be claimed up to the amount of tax payable for the year in question.

Where the charitable donation or gift to her Majesty consists of capital property which, at the time of the donation, 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 proceeds of disposition of the property of the deceased 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 legal representative may designate the amount of the 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.

A T871 form (*Cultural Property Income Tax Certificate*) issued for this property by the Canadian Cultural Property Export Review Board, together with the official receipt issued by the institution that received the gift, must be attached to the return of the deceased in support of the amount indicated on line 342 for a cultural gift.

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

For further information, consult Interpretation Bulletins IT-297R, *Gifts in Kind to Charity and Others*, and IT-407R2, *Disposition of Canadian Cultural Property*, and the brochure entitled *Gifts in Kind*.

4. Income earned after death

Income that is attributable to the period after death is reported by the estate on a T3 Trust Return. The 1989 Guide to the T3 Trust Return provides additional information and may be obtained from any district office.

5. Payment of tax

For the year of death, the legal 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 pay 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 return is due. A copy of form T2075 must be submitted to the district taxation office in the area where the taxpayer resided before his death, no later than the date on which the first of the equal consecutive annual instalments is due.

Note:

Security acceptable to the Minister must be furnished to guarantee payment of the deferred tax. To make security arrangements, contact the collections section of the district office serving the area where the taxpayer resided before his death.

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 for the deceased 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 legal representative is located. The request should identify, by name, address and title (such as executor or administrator), the person(s) requesting the certificate and should indicate the full name, last address, Social Insurance Number and date of death of the deceased.

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 1989 Guide to the 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, identify the administrator and submit 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 Certificates for Estates and Trusts* and Interpretation Bulletin IT-282R, *Estate or Trust Distributions — Clearance Certificates*.

REFERENCES

For further information, please obtain the following publications from a district taxation office.

Guides

General Tax Guide
 Capital Gains Tax Guide
 Pension and RRSP Tax Guide
 Business and Professional Income Tax Guide
 Northern Residents Deductions Tax Guide
 Guide to the T3 Trust Income Tax Return
 Tax Guide for Emigrants
 Tax Guide for New Canadians
 Farming Income Tax Guide
 Fishing Income Tax Guide
 Rental Income Tax Guide
 Employment Expenses Tax Guide
 Child Care Expenses Tax Guide

Brochures

Gifts in Kind
 How You Claim the Disability Credit

Forms

T1A Request for Loss Carry-Back
 T541 Forward Averaging Tax Calculation – Deceased Taxpayers
 T657 Calculation of Capital Gains Deduction (1989)
 T691 Calculation of Minimum Tax
 T936 Calculation of Cumulative Net Investment Loss on December 31, 1989
 T2019 Registered Retirement Savings Plan Refund of Premiums Designation – Spouse
 T2069 Election in Respect of Amounts Not Deductible as Reserves for the Year of Death
 T2075 Election under subsection 159(5) to Defer Payment of Income Tax on the Deemed Disposition of Property
 T2086 Capital Dispositions Supplementary Schedule
 T2204 Calculation of Employee Overpayment of Canada Pension Plan Contributions and Unemployment Insurance Premiums

Interpretation Bulletins

IT-84 Capital Property Owned on December 31, 1971 — Median Rule (Tax-Free Zone)
 IT-139R Capital Property Owned on December 31, 1971 — Fair Market Value
 IT-140R3 Buy-Sell Agreements
 IT-172R Capital Cost Allowance — Taxation Year of Individuals
 IT-172R Special Release Dated June 13, 1986
 IT-207R “Tainted” Spouse Trusts
 IT-210R Income of Deceased Persons — Periodic Payments
 IT-212R2 Income of Deceased Persons — Rights or Things

IT-217 Capital Property Owned on December 31, 1971 — Depreciable Property
 IT-217 Special Release Dated September 13, 1982
 IT-234 Income of Deceased Persons — Farm Crops
 IT-278R Death of a Partner or a Retired Partner
 IT-282R Estate or Trust Distributions — Clearance Certificates
 IT-297R Gifts in Kind to Charity and Others
 IT-301 Death Benefits — Qualifying Payments
 IT-305R3 Establishment of Testamentary Spouse Trust
 IT-326R Returns of Deceased Persons as “Another Person”
 IT-329R Income of Deceased Persons — Resource Properties
 IT-337R2 Retiring Allowances
 IT-344R Eligible Capital Property — Deceased Persons
 IT-349R2 Intergenerational Transfers of Farm Property on Death
 IT-382 Debts Bequeathed or Forgiven on Death
 IT-407R2 Disposition of Canadian Cultural Property
 IT-416R3 Valuation of Shares of a Corporation Receiving Life Insurance Proceeds on Death of a Shareholder
 IT-427 Livestock of Farmers
 IT-449R Meaning of “Vested Indefeasibly”
 IT-486R Intergenerational Transfers of Shares of a Small Business Corporation
 IT-500 Registered Retirement Savings Plans (maturing after June 29, 1978) Death of Annuitant after June 29, 1978
 IT-502 Employee Benefit Plans and Employee Trusts
 IT-508 Death Benefits — Calculation

Information Circulars

82-6 Requesting Clearance Certificates for Estates and Trusts
 86-6 Basic Herds

Improvements to the Guide

Every year, we revise this Guide in order to improve it. If the explanations provided in a particular paragraph cause you problems, or if you have any observations or suggestions, we would appreciate hearing from you.

Please write to us at the following address:

Tax Forms Directorate
 875 Heron Road
 Ottawa, Ontario
 K1A 0L8

Common questions

- Q. What return must be completed for a deceased person: T1 Special, T1 General or T3?**
- A.** You must complete a T1 General or a T1 Special return for the period from January 1 to the date of death. You must prepare a T3 return if there is income from a trust established as a result of the taxpayer's death.

Q. My father died in February. Must I wait until next year's return is published before completing his return for the two months?

A. No. You can simply use the most recent T1 return and change the date. Any change in the Act will be taken into consideration in the assessment of the tax.

Q. Who must report the vacation pay and payment of accumulated sick leave?

A. Vacation pay constitutes taxable income for the deceased person. The payment of accumulated sick leave is usually part of the taxable income of the one who receives it (ie, the estate or beneficiaries). However, accumulated sick leave paid following the death of an employee may, in certain circumstances, be considered death benefits, and, if so, receive more-favourable tax treatment. Consult the General Tax Guide, line 130(C).

Q. Who must report death benefits paid by an employer?

A. Death benefits are part of the taxable income of the one who receives them (ie, the estate or beneficiaries).

However, for an amount recognized as a death benefit, the first \$10,000 (less amounts of this kind already received) is tax-free.

Q. How are capital gains and recovery of the capital cost allowance calculated?

A. All capital property is deemed to have been disposed of at death. A capital gain or recovery of the capital cost allowance, if any, is calculated as of the day of death. Please read item 1, Part III, for an explanation of certain rules applicable to deemed dispositions.

Q. How are personal tax credits determined for the year of death if the spouse and children received income before and after the taxpayer's death?

A. It is necessary to include income received during the entire calendar year by the person for whom the personal tax credit is claimed, whether this be the spouse, dependent children or other dependants.

Throughout the Guide, we direct you to forms that must be attached to your return. We also mention, where appropriate, other publications that cover topics in more detail.

If you need one of these forms or a publication, complete the order form below. Your order can be filled by your local

district office by mail, telephone, or while you wait. Please refer to the 1989 *General Tax Guide* for addresses and telephone numbers.

If you prefer to mail the order form or leave it in person, please print your name and address on it. If you mail the order form, allow **three weeks** for delivery.

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