

Estates and Trusts Law

December 14, 2010

Allocation of Trust Income to Beneficiaries - Something to Add to Your Year-End Checklist

Under the *Income Tax Act* (Canada) (the "Act"), a Canadian resident trust is taxable on its worldwide income earned in the year. However, the Act permits a trust to take a deduction for amounts **paid or payable in the year** to a beneficiary, who then must include such amounts in his or her income. With the increase in Canada Revenue Agency ("CRA") audit activity surrounding the creation and administration of Canadian trusts, it is important for trustees to bear this in mind, especially as we near the end of the year.

The Act deems amounts not to have become payable to a beneficiary unless the beneficiary was entitled in the year to enforce payment of the amount. For purposes

of the relevant trust provisions in the Act, the term "payable" refers to an immediate legal obligation to pay when the payment has not yet been made.

Accordingly, to ensure the deductibility of 2010 income allocated to a beneficiary, trustees of Canadian trusts who intend to allocate (but not actually pay) some or all of a trust's income should evidence such intention in writing *prior* to the end of the year. If the income is not yet ascertained, consider estimating the income that will be earned in the trust during the period between the date of the resolution and the end of the year.

The beneficiary must be entitled to enforce payment of the allocation in the year and it is CRA's view that the beneficiary must be notified of the allocation in writing. If the trust document allows trustees to issue promissory notes, a demand promissory note should be delivered to the beneficiary (or if the beneficiary is a minor, to his or her legal guardian) as soon as the amount payable to the beneficiary is quantified, unless the amount is paid at that time.

For further information or answers to questions regarding trust allocations, please contact the trusts and estates lawyers at Goodmans LLP, Patricia Robinson (416.597.4144) or Janice Dubiansky (416.849.6894).