Masters Series

Planning your estate? Think about including a trust

By John C. Armstrong Q.C. and Siân M. Matthews, Bennett Jones LLP

Strategies

THIS IS ONE OF A SERIES OF ARTICLES PREPARED FOR CIBC PRIVATE WEALTH MANAGEMENT. THE SERIES IS WRITTEN BY PROFESSIONALS IN SUCH FIELDS AS TAXATION, TRUSTS, AND ESTATES.

Trusts are often an integral part of estate planning in Canada because they provide a great deal of flexibility in meeting the objectives of an estate plan. In addition, trusts are an important part of tax planning for individuals and closely-held corporations.

Trust basics

A trust is essentially a legal concept that relates to the ownership of property, whereby legal title to property is vested in a trustee. That trustee is obliged to hold and administer the trust property for the benefit of the beneficiaries, who have an interest in the trust's property and/or income.

The settlor creates the trust by "settling" the trust with some property. Generally, a gift of property to a trust is a disposition for tax purposes and may generate capital gains.

The settlor and trustee execute a trust deed evidencing the settlor's intention to create the trust, as well as setting out the rights, duties, and obligations of the trustee and the principles governing the trust. Generally, the trust deed provides the trustee with broad powers to deal with property.

The trustees become the legal owners of the trust property and are under a fiduciary obligation to manage the trust property in the best interest of the beneficiaries. (In Quebec, the trustee does not become the owner of the trust property but the trustee has the obligation to hold and manage the property. The ownership of the property is transferred to the trust.)

All trustee decisions must be properly reflected in resolutions and documents. We recommend that the trustee establish and maintain the equivalent of a corporate minute book to retain the trust deed, banking documents, and all trustee resolutions.

A corporate trustee may be chosen for its expertise, impartiality, and ability to deal with complex situations.

Benefits of using a trust

The following are some benefits of using a family trust structure.

1. Income splitting. Trusts can be an effective way to achieve income splitting, particularly with children (subject to the potential application of the attribution rules and the "kiddie tax"). The kiddie tax does not apply to income from listed securities, unless such income is earned through a holding corporation. It is possible to avoid application of the attribution rules, but the various mechanisms are beyond the scope of this article.

2. Capital gains splitting. Trusts can be used to transfer appreciation in capital property, such as shares, to other family members, especially children. Generally stated, there is no attribution of taxable capital gains earned by minors. In this circumstance, the minor beneficiaries would be subject to tax on the capital gains at their marginal rates.

Siân M.Matthews is a partner and head of the Private Client Group at Bennett Jones LLP. John C. Armstrong, Q.C., is Counsel to Bennett Jones LLP. With offices in Calgary, Toronto, and Edmonton, Bennett Jones LLP is a top-tier Canadian law firm specializing in energy, corporate law, tax, and litigation.

3. Capital gains exemption. Beneficiaries may be eligible to claim the $750,000 enhanced capital gains exemption on the capital gain allocated to them from the disposition of certain types of shares (and certain other property). Both the beneficiary and the corporation must meet all relevant tests at the time of disposition, and the trustee must allocate the capital gains to the beneficiaries. As a result, the $750,000 capital gains exemption may be multiplied by the number of family members who are beneficiaries of the trust, without direct share ownership.

4. Reducing tax liability at death. Transferring assets to a trust may limit the size of the individual's estate, such that tax liability at death is reduced. In addition, probate fees may be reduced. (Probate fees are not applicable in Quebec.)

5. Creditor protection. Trusts offer some degree of creditor protection when the beneficial ownership of assets shifts to other beneficiaries.

6. Control of trust property. By holding assets in a trust all of the above benefits can be achieved while the trustees maintain full control (subject to their fiduciary duties as trustees) over the trust property. It is important to note that it is the trustees who control the trust property and not the settlor. The settlor, however, sets the terms of the trust in the trust deed and the trustees are bound to act according to the terms of the trust deed as well as general trust law.

Discretionary vs. non-discretionary

A family trust can be either discretionary or non-discretionary. A discretionary trust gives the trustee full discretion to allocate income and capital among beneficiaries.

In a non-discretionary trust, the trust deed sets out the parameters within which income and capital are allocated. For example, if a trust has three beneficiaries, each beneficiary could be entitled to one-third of the income on an annual basis, and one-third of the trust capital when capital allocations are made.

Most trusts are irrevocable, as the tax rules deem any income or capital gains earned by a revocable trust to be those of the contributor and taxed in his or her hands, and not income or capital gains of the trust.

Taxation of a trust

For income tax purposes, an inter vivos trust (that is, a trust created during a person's lifetime) is considered an individual and subject to tax at the top marginal tax rate on its taxable income for a calendar year-end. A testamentary trust (that is, a trust that is created on the death of an individual) is subject to graduated marginal tax rates and may have other than a calendar year-end.

Initially, the trust's income is determined in essentially the same manner as an individual's income. However, the trust may deduct its income that is either paid or payable to beneficiaries. Income is not considered paid or payable unless it was paid during the year, or the beneficiary was entitled to enforce payment.

Generally, a trust is deemed by the tax rules to dispose of its capital property every 21 years. This deemed disposition may result in a large tax bill, and steps may be required to distribute the capital property of the trust to the capital beneficiaries prior to the deemed disposition date. Planning opportunities should be considered prior to the 21-year trigger date.

Seek advice

The 21-year rule is just one of many potential complexities involved in using a trust effectively. To ensure that all areas are adequately addressed and all planning opportunities exploited, it's advisable to work with a professional who specializes in trusts and estate planning issues.

Trusts can be an effective part of your tax and estate planning. This article is a brief summary of some features of trusts and is not a thorough examination. Contact your lawyer or accountant for more information.

Estate planning is a complex area involving the law of wills, trusts, powers of attorney, and Canadian and U.S. tax. Legislation varies from province to province, and is subject to change.

This article is intended to provide general information only and should not be construed as specific advice. Since a consideration of individual circumstances is critical, anyone wishing to act on information in this article should consult his or her professional advisors. This article reviews Canadian federal tax and other laws only, unless otherwise stated. Provincial tax and other laws may also apply and may differ.

The Masters Series of articles is provided as an information service only, and the information is subject to change without notice. The information is believed to be accurate at the time of writing but CIBC does not represent or guarantee accuracy, completeness or suitability. The opinions expressed therein do not necessarily represent the views of CIBC. Please consult your own professional advisors for further advice concerning your particular situation.
CIBC Private Wealth Management consists of services provided by CIBC and its subsidiaries.

172A485E 12/09