LAURA KERR

Estates Law Practice

17 Gavin Street
Ottawa, Ontario
K1V 9X4

(613) 614-7140
lkerr@estateslaw.ca
www.estateslaw.ca

TRUSTS

Definition

A trust is not a separate legal entity, but rather a relationship among a person who owns an asset to be placed in trust (the "settlor"), one or more persons who will hold the asset (the "trustees"), and one or more persons for whose benefit the asset will be held (the "beneficiaries").

The trustees must hold the trust assets on the terms set out in the trust document. You must therefore decide who will be your trustees, what powers they will have, how long the trust will last, and who will be the beneficiaries both during the term of the trust and on its ultimate distribution.

Testamentary trusts

A testamentary trust is one established by the terms of your Will, and it comes into existence only when you pass away. Some of the advantages of creating a testamentary trust are as follows:

- If you don't want a child to receive his or her entire inheritance at age 18, you can provide for the money to be held in trust and paid out at a later age or in stages (e.g. 1/3 at age 21, 1/3 at age 25, and 1/3 at age 30). In the meantime, the trustees can make payments out of the trust to cover educational or medical expenses, to help the beneficiary start up a business or purchase a home, or for any other reason.

- You can ensure continued care for a beneficiary who is unable to manage property wisely or who is mentally or physically challenged. A trust for a disabled beneficiary can be structured so as to preserve the beneficiary's entitlement to government disability benefits; see my information sheet on "Henson Trusts" for more details.

- You can protect or preserve a particular property, such as a business or cottage.

- You can retain control over the choice of alternate beneficiaries. For example, instead of leaving your estate directly to a surviving spouse who might remarry and leave your assets to the new spouse, you can ensure that your estate eventually passes to your children.

- Income can be taxed in the trust starting at the lowest graduated rate, even if the beneficiary of the trust is already in a high tax bracket. For additional tax savings, you can allow income earned in the trust to be "sprinkled" among the primary beneficiary of the trust and his or her family members.

- You can create future savings of probate fees on the death of the beneficiaries of the trust because the assets of the trust never pass from your estate to the estates of the beneficiaries.

- By creating a trust for a charity, you can direct how the money is used by the charity and create tax savings in your year of death or for your estate.

Inter vivos trusts

An inter vivos or living trust is one established during your lifetime. The trust will come into effect as soon as the trust deed is signed, but it can continue past your death if you so provide. Some of the advantages of an inter vivos trust are as follows:

- Unlike a will, the trust agreement can remain a private document between you and your trustee.

- A trust can be a cost-effective way of providing financial support to other family members (such as an aging parent, an adult child in long-term education, or a mentally or physically challenged beneficiary) because it allows for the payment to such beneficiaries of pre-tax dollars rather than after-tax dollars.

- A trust created either for your own benefit, or instead of a direct gift to a family member, may protect the assets within the trust from claims of a spouse or creditors of the primary beneficiary.

- A trust can relieve the stress of financial management by having a corporate or other professional trustee manage your investment portfolio for the exclusive benefit of you and/or your spouse during your lifetime, even if you become incapable or one spouse dies.

- Assets owned by a trust at your death will not be subject to probate fees.

- If you own a private corporation, a trust can allow you to retain control of your business while simultaneously involving your children in the business and/or reducing your potential tax liability on the transfer of the shares of the corporation after your death.

- In addition, if the shares of the corporation are eligible for the $500,000 lifetime capital gains exemption, access to the exemption may be multiplied among the beneficiaries of the trust.

- By creating a trust for a charity, you may obtain an immediate tax benefit while still retaining the right to receive income from the trust during your lifetime.

Disadvantages of Trusts

The advantages described above must be balanced against the potential disadvantages of a trust. For example:

- Trustees are subject to various administrative and fiduciary duties (explained in more detail in my information sheet entitled “Duties of Trustees”), and may be held financially liable for breaching these duties. Before creating a trust, you should discuss with the persons you wish to name as trustees whether they are willing to take on the burden of administering the trust.

- Even if the primary beneficiary of a trust is the sole trustee, he or she will not have the same absolute rights of ownership over the trust property that he or she would have if you were to make a direct gift. If you propose to create a trust for an adult capable beneficiary purely or primarily for tax reasons, you should ensure that the beneficiary understands and accepts these limitations.

- Annual administration costs associated with running a trust include fees for the preparation of tax returns and trustee accounts, investment counsel fees, and trustee compensation as approved by the beneficiaries or allowed by the court on an application.

- If improperly structured, a trust can create adverse tax consequences including the acceleration of capital gains tax (both on the creation of the trust and every 21 years thereafter), the taxation of income earned in the trust at the highest marginal rate, and the attribution to you for tax purposes of income that is retained in the trust or paid out to certain family members.

Terms of the Trust

Once the decision is made to create a trust, the person creating the trust must consider the following matters:

Choice of Trustees

It is important to choose the trustee or trustees carefully. You must be able to trust them to manage the property honestly and wisely, and to consider the needs of each beneficiary and meet them if it is possible and reasonable to do so. In some cases, you may wish to appoint a trust company, lawyer, or other professional advisor as the sole trustee or as a co-trustee with a family member; such persons are experienced at dealing with investment, accounting and legal requirements, and can help reduce potential conflicts among the beneficiaries.

Choice of Beneficiaries and Identification of Their Entitlements

In most cases, the trust will continue for a defined term such as the lifetime of a beneficiary or until a beneficiary reaches a certain age. During this term, you must stipulate whether the trustees may distribute income or capital or both, whether such distributions will be within the discretion of the trustee or determined by some objective criteria (such as for certain expenses, or in a certain dollar amount or percentage each year), and, if distributions may be made to more than one beneficiary, whether the various beneficiaries should be treated equally. If you wish the trust to retain or purchase certain property (such as a home) for the benefit of the beneficiary, the trust agreement should stipulate this, and also provide for payment of any expenses associated with the upkeep of the property.

You must also determine when the trust will terminate, and who will become entitled to the assets remaining in the trust at that time. Typically, the ultimate beneficiaries will be the children and other descendants of the primary beneficiary, more distant family members, or charities. Alternatively, the primary beneficiary can be given the right to determine to whom the remaining assets will be distributed.

Powers and Duties of Trustees

A trust agreement also contains detailed administrative provisions either expanding the powers of the trustees (in order to give them the flexibility to deal with unanticipated future events) or in some cases limiting these powers (to ensure that they administer the trust property in accordance with the intention and policies of the settlor). For example, the trust document can give the trustees conservative or broad discretion in making investment decisions, distributions to the beneficiaries, income tax elections, and decisions as to how to manage a business whose shares form part of the trust fund. In addition, the trust agreement can set out whether and how much compensation should be paid to the trustee for his or her work in administering the trust.

Conclusion

Whether a trust would make sense for you and your family will depend on various tax and non-tax considerations. For professional assistance in making this decision, and in implementing a trust, please contact Laura Kerr at (613) 614-7140 or lkerr@estateslaw.ca.