TRUSTS FOR PROTECTION AND TAX SAVINGS

What if your son is in a new business venture with personal guarantees and needs protection from creditors? What if your child has a substance abuse problem? Or are you concerned that your daughter will lose her source of income in the event of a divorce? The solution to these concerns may be a trust.

Trusts provide protection for your wealth and beneficiaries, and can also be used to reduce taxes. They can be created now, or upon your death in your Will as part of an effective estate plan.

A trust is often used to provide for one person or group of persons now, with a "gift over" to another person or group at a later time. For example, in the case of a second marriage, a spousal trust is often created to maintain the lifestyle of the surviving spouse with a gift over to the children of the first marriage. The trust ensures capital is preserved for the children since the spouse has limited access to the trust fund.

Trusts can be used to provide financial security for a special needs beneficiary such as a disabled child or other beneficiary with ongoing financial needs. In most provinces, a discretionary trust can be used to preserve a beneficiary's right to provincial disability benefits.

How Do Trusts Work?

Trusts permit the separation of legal and beneficial ownership of property. Control of the property is transferred to the trustee but the beneficiary can enjoy the use or benefit of trust property on whatever conditions are created in the trust document.

The trust document contains the instructions to the trustee. The terms may include how income and capital are to be distributed, when the trust is to end and who receives the remaining property in the trust at that time. The trustee may have mandatory instructions as to the division and timing of distributions of income and capital during the time the trust property is being administered. More often the trustee has discretion, which can be restricted or absolute.

There are few restrictions in creating trusts; the trust must end eventually, and the beneficiary must be a legal person or a charity. The beneficiaries can be named, or they can be defined as a class of persons. "All my descendents", or "my children and grandchildren" are examples of classes of beneficiaries, and the members of the class can continue to grow as additional persons are born.

Choosing the trustee is particularly important where the trust is being used for protection. The beneficiary should not be the sole trustee, but in some circumstances can be a co-trustee along with an independent trustee. Remember, the trustee needs to be capable of managing trust property and exercising discretion until the trust is ended and all property is distributed. It may be appropriate to provide for successive trustees. A trustee can be given the power to appoint his or her successor. Another option is to use a trust company, either as an initial trustee or as a fallback – since it has perpetual existence. A trust company can also act as an impartial party and provide professional trust administration.

Tax Planning Advantages

Trusts that are created as part of your estate plan to be set up after death (called "testamentary") have several tax advantages over trusts set up during your lifetime (called “inter vivos”).

Testamentary trusts can be used to create a tax shelter for beneficiaries by reducing the tax rate on the investment income from the inheritance. Testamentary trusts have the same graduated tax rates as an individual taxpayer. This permits income splitting between a testamentary trust and the beneficiary with potential tax savings of up to $10,000 per annum. Testamentary trusts can be used to income split between the trust and a surviving spouse, or the trust and a surviving child or any other beneficiary.

The attribution rules that restrict the ability of trusts to income split do not apply to testamentary trusts. A trust can be set up for minor children, such as grandchildren, and interest and dividends paid or made payable to them can be taxed at their lower marginal rates. For example, your Will could create and fund a family trust for each of your children and their family members. Your child could be appointed the trustee with ability to “sprinkle” income to any number of persons on a discretionary basis. Capital distributions can also be at the child’s discretion. It’s like leaving your children a tax shelter as part of your estate plan.

Inter vivos trusts can also be used in tax planning. For example, a trust for minor children can be effective to reduce tax on capital gains realized in the trust. Or a trust for adult beneficiaries can provide financial assistance in a more tax efficient manner if the beneficiary is in a lower tax bracket than the contributor to the trust.

The protection and tax planning opportunities provided by trusts makes them an attractive financial and estate planning tool. Trusts are also extremely flexible and can be designed to suit the creator’s exact purpose.

A professional advisor is essential to trust, estate and tax planning. Contact your Investment Advisor if you would like an introduction to a professional advisor.

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