Trusts for Asset Protection and Tax Savings

Succession Planning and Trusts

A Trust is a special way of holding property which, if structured properly, can provide protection from creditors, can guide the management and use of your wealth during your lifetime and after death, and can serve as a strategy to reduce various taxes. If you wish to transfer your wealth to your children but you have concerns about their ability to manage the wealth, or if you worry that your children may not protect and preserve the wealth beyond their lifetime (perhaps due to a spendthrift lifestyle or marital difficulties), using a Trust as a vehicle to transfer your wealth across generations may be the solution.

The Mechanics of a Trust

The term **Trust** symbolizes a relationship which is created when a person who initially owns property (the **Settlor** of the Trust) transfers possession and legal ownership of the property to someone else (the **Trustee** or **Trustees** of the Trust) to hold the property for the benefit of someone else (the **Beneficiary** or **Beneficiaries** of the Trust) according to certain terms. In order for a Trust to be validly created, there must be:

i) expressed (verbal or written) intention of the Settlor to permanently give up possession and control of the property and to create the Trust accompanied by delivery to the Trustees of the Trust property,

ii) a clear and precise description of the property to be held in the Trust, and

iii) a clear and precise description of who the Beneficiaries are.

These are referred to as the **Three Certainties**.

The Trust is not a legal entity, but under the **Income Tax Act**, is considered a separate taxpayer for income tax purposes. It is the Trustee who represents the Trust because he or she has legal rights to the property. Therefore, only the Trustee can take actions on behalf of the Trust. The Trustee must act according to the intentions of the Settlor as expressed in the Trust document (commonly referred to as the **Trust Declaration**, **Trust Agreement**, **Trust Deed**, or **Trust Instrument**). The beneficial ownership vests in the beneficiaries, and the trustee's actions are rooted in his or her fiduciary duty to act in the best interest of the beneficiaries. It is the separation between legal and beneficial ownership that gives the Trust its flexibility in the control and protection of the trust property, and the management and distribution of the Trust property.

The Trust Declaration

A properly drafted Trust Declaration is a crucial part of an effective Trust structure. The Trust Declaration reflects the Settlor's intentions and outlines the powers granted to the Trustee. In particular, it contains instructions to the Trustee regarding how income and capital distributions are to be made, when and to whom. The Trust Declaration determines when the Trust will be terminated and who the ultimate Beneficiaries will be (perhaps other family members or charities).

In Canada in addition to the **Three Certainties**, a Trust must meet certain requirements in order to be valid. This means that the language used in the Trust Declaration – the terms of the Trust – must be considered carefully. For example, a Trust cannot exist indefinitely. Properly structured, a Trust can be used by a grandparent to provide for the distribution of his or her wealth to grandchildren who are not yet born. The choice of the Trustee must also be considered carefully. Among other requirements, the Trustee should possess sufficient knowledge regarding financial affairs including investments. He or she should not be in a position of conflict with any of the Beneficiaries' interests. In some circumstances it is appropriate to appoint a professional Trustee, namely, a corporate Trustee. This option is advantageous in that the corporate Trustee does not become incapacitated nor die leaving a void, and the corporate Trustee is not related to family members who are Beneficiaries, so this Trustee is truly independent, with no conflict of interest.

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Advantages of Using Trusts

Properly drafted, Trusts can provide various non-tax related and tax related advantages. For example, without a Trust your assets may be vulnerable to creditors, they can be depleted by spendthrift family members, or be subject to higher taxes. Generally, property held in a Trust for the benefit of others is not subject to probate tax (or probate fees depending on your province) upon your death since such property does not form part of your estate. Probate costs vary from province to province. In Nova Scotia, using a Trust specifically for purposes of probate planning as part of your overall estate plan may translate into estate savings of approximately $14,000 for every $1 million held in the Trust.

Limited Tax Benefits of Testamentary Trusts

Commencing in 2016, Trusts created in your Will can no longer take advantage of graduated tax rates beyond a period of three (3) years after date of death. However, all Trusts continue to have tax related (in addition to non-tax related) benefits. The Trust is a taxpayer, and as such, it must file annual income tax returns. Where an adult beneficiary's rate of tax is lower than that of the Trust, then, depending on particular circumstances, income splitting and therefore tax reduction can be achieved.

The Family Trust

A reduction in probate tax and income tax across generations can be achieved by using a Trust. Your adult child and grandchildren can receive income and capital distributions during your lifetime and pay less income tax than you would, if they are earning at lower tax brackets. Upon your death, your estate would not have to pay probate on the property held in that Trust and your child and grandchildren would continue to receive income and capital distributions. Upon the death of your adult child, the property still held in the Trust would not be subject to probate, a savings of probate tax for the estate of your child. Your grandchildren could continue to receive income and capital distributions from the Trust after the death of their parent, depending on the specific terms of the Trust you created.

The Spousal Trust

A spousal Trust is often used to deal with more complex family structures, such as when your spouse is not the parent of your children. Such a structure is effective to ensure that your surviving spouse is able to maintain his or her standard of living and lifestyle after you are gone, while preserving (to the extent that you dictate in the Trust document) the capital for the benefit of your own children. The spousal Trust is created to benefit your surviving spouse during his or her lifetime by way of mandatory income distributions and discretionary capital distributions. Upon your surviving spouse's death, your children would receive all the property, originally your wealth, remaining in the spousal Trust.

Trusts for Adults with Disabilities

Trusts are often used for the benefit of a disabled Beneficiary without jeopardizing that Beneficiary's right to government disability benefits. It is also possible to create a Trust for a spendthrift beneficiary and structure it to prevent the depletion of the Trust assets and provide protection from creditors.

For more information, please ask your BMO financial professional for a copy of our publication entitled Trust Planning for the Disabled.

Conclusion

The asset protection and tax planning opportunities provided by Trusts makes them an attractive financial and estate planning tool. Trusts are extremely flexible and can be tailored to address specific needs.

Professional advice is essential when creating a Trust. Contact your BMO Nesbitt Burns Investment Advisor if you would like an introduction to a professional advisor, in order to understand the potential benefits of using a Trust for your family in your financial planning.

For more information, speak with your BMO financial professional.

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