ESTATE PLANNING: Understanding Trusts

When developing an estate plan, the inclusion of a trust, or multiple trusts, may help you to achieve your personal objectives and enhance benefits to be received by future generations.

WHAT IS A TRUST?

A trust is a relationship where a person (the settlor) transfers property to another person or company (the trustee) who holds that property for the benefit of another person (the beneficiary). In general, it is possible to have more than one settlor, trustee, and/or beneficiary of a trust.

TYPES OF TRUSTS

There are two categories of trusts: i) inter vivos, a trust created during the settlor's lifetime; and, ii) testamentary, a trust created as a consequence of an individual's death by way of their will.

TAXATION OF TRUSTS

Since a trust is a relationship and is not generally recognized as a legal entity, trusts are regarded as individuals for income tax purposes.

In an inter vivos trust, all of the trust's income is generally subject to tax at the highest marginal rate for individuals. With the exception of a Graduated Rate Estate (a designated testamentary trust subject to tax at the graduated rates in the same manner as an individual for the first 36 months of an estate), testamentary trusts are also subject to tax at the highest marginal rate for individuals.

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While trusts are treated as individuals for tax purposes, they do not receive the benefit of being able to claim personal tax credits.

All, or a portion, of the income earned by a trust in a taxation year can be paid or made payable to all, or some, of the beneficiaries of the trust. This income will retain its character (e.g., eligible dividends, capital gains, etc. earned by the trust and distributed to beneficiaries will be considered to be eligible dividends, capital gains, etc. of the beneficiaries) and will be subject to tax in the recipient beneficiaries' hands. Any income that is not distributed to the beneficiaries in a taxation year will be subject to tax within the trust.

POTENTIAL USES AND BENEFITS

A trust may be used as part of an estate plan to provide some of the following benefits:

Income Splitting —Tax savings may be achieved by distributing all, or a portion, of the income earned by the trust to beneficiaries who are subject to tax at a lower marginal rate than the trust, or who have unused loss carry forward balances or personal tax credits, since the income will be taxed in the beneficiaries' hands.

In the case of an inter vivos trust, careful planning is required to ensure that the income attribution rules do not apply in any potential income splitting strategy.

Asset Protection — If structured properly, trusts may help to protect assets from your/the beneficiaries' creditors, the potential breakdown of your/the beneficiaries' marriage, and from the beneficiaries themselves (in the event they are minors, disabled, or not currently at a stage in life where they have the capacity to own certain assets outright).

Further, for individuals residing in certain provinces, the trust may protect the assets held within it from estate administration (i.e., probate) fees.

If you would like to further explore the potential benefits of setting up a trust, or need assistance with other aspects of the estate planning process, please give us a call or visit our website.

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