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Family Trusts

The term "family trust" receives considerable attention from both the media and the government at various times. Yet the average Canadian does not really understand what the family trust is, much less, how they could benefit from setting one up. This summary attempts to remove some of the mystery.

WHAT IS A TRUST?

Put simply, a trust is a means by which assets of one person (the settlor) can be transferred to one or more other persons (the beneficiaries), but remain under the control of a third person or group of persons (the trustee). One common example is a trust established by deceased parents for their minor children. The settlor (the deceased parent) transfers his accumulated wealth to a trust. The beneficiaries (minor children) are to benefit from this wealth. However, as minor children, they are not capable of wisely managing these funds. As such, the parent names a trustee (in this case, likely the legal guardian of the children) to manage the funds for the children until they are able to manage the funds on their own.

WHAT CAN A TRUST DO FOR ME?

A trust enables you to transfer wealth to another person without necessarily giving up control of the funds. Under the above example, you have left all your wealth to your children at a time when they were not able to manage the funds themselves. This would happen automatically if your will left funds to a minor child. The law related to such funds would then determine the terms of the trust.

Alternatively, you could set the terms of the trust in your will. For example, you could name the trustee(s) of the Trust. You could mandate that your assets be divided equally among all your children, prescribe different proportions (perhaps because one child has a greater need for funds) or even provide your trustees with discretion to allocate the trust funds between your beneficiaries as they see fit.

You can also set the time(s) when your beneficiaries will receive the trust assets. A specific date could be set (eg. the date on which the child reaches age 25), a gradual payout could be structured (eg. 1/3 at age 25, ½ of the remainder at age 30 and the remaining funds at age 40), or you could provide your trustees with discretion. The trustees could be empowered to prepay some or all of the trust funds prior to dates specified by you, or could have full discretion as to when funds are distributed.

Trusts set up on death also have the potential to provide considerable tax advantages, and should be considered in your estate planning. This issue is beyond the scope of this

SO I HAVE TO DIE TO MAKE THIS WORK?

No – a trust can also be set up during your lifetime. Say, for example, you wanted to transfer $100,000 to a six-year-old child. You do not know how responsible that child will be at age 18, making you reluctant to allow the child to simply have the cash on his 18^{th} birthday. Instead, you pay the $100,000 to a trust for the child. You could even name yourself as the trustee, allowing you to control the use of the money throughout your life. You would then decide when, or whether, the income from these funds, or even the original $100,000, would be transferred to your child.

WHAT ABOUT INCOME TAXES?

Trusts evolved due to issues of control over assets transferred. However, because trusts are extremely flexible vehicles, they can be used to create tax advantages. Historically, some advantages have been perceived as unreasonable by the government. As such, a complex web of tax legislation has developed around trusts to prevent the "undue" avoidance of income taxes.

Nevertheless, considerable opportunities for tax savings within a properly planned trust structure remain. Here are just a few examples of the use of trusts:

1. A properly structured trust can hold investments for adult or minor children, grandchildren or other family members. Some or all of the income from these investments can then be reported by the children, potentially reducing the family's overall tax bill. Both the type of investments and the ages of the children, greatly influence the planning opportunities available.

2. A trust could hold shares of a family business corporation. This would enable you, for example, to allow your children to acquire an interest in the future growth of the corporation without giving up control of the business. Your children would be beneficiaries of the trust, with you being the trustee. As such, while the growth in the value of these shares, as well as any income, would ultimately belong to your children, you would control the voting rights of the shares, as well as the amount and timing of any assets being received by the children themselves. You could also be a beneficiary, to provide for assets you do not wish to distribute to your children to revert to you.

   The tax benefits of paying income from private companies to family members not active in the business have been sharply restricted by legislation as recently as 2017. However, some benefits are sometimes still available where shares are held in trust for family members. As well, significant tax savings can often be realized when the business is sold, and these typically require creating the appropriate trust structure well before that time. Further, advance planning positions you to be able to bring any children who later become participants in the business into an ownership position on a tax-efficient basis.

3. It is sometimes possible to reduce the tax cost of caring for a disabled child (or other relative) by transferring assets to a trust for the benefit of the child. This can reduce the after tax cost of support by enabling income to be reported by the child. In such cases, it is important to carefully review the impact of such a trust on available government programs.

So it's that easy?

Well, unfortunately, it is not. A trust creates certain legal liabilities on the trustee, who has an absolute legal obligation to manage the trust assets in the best interests of the beneficiaries. As well, the income tax provisions related to trusts are quite complex, and it is sometimes necessary to sacrifice some control in order to achieve the desired income tax results. In general, trust funds must someday pass to the beneficiary. It is not, for example, possible to have a child report income of a trust and then allow his parents to receive the funds for their personal spending. Often, however, spending on behalf of the child can be done by the trust instead of the parents, resulting in a significant income tax savings. We anticipate any parent will agree that substantial family funds are dedicated to costs incurred for the children! Among other things, such a structure can assist in funding a child's education, recreational activities such as athletics, vacations, and other expensive items.

The legal framework under which trusts are created allows for considerable flexibility. However, the income tax rules surrounding trusts are complex and numerous, and can produce surprisingly onerous results. As such, the creation of a trust to meet your needs on a tax-effective basis requires careful planning. As with any tax planning there is the risk that the tax rules governing family trusts will change over time. We would be pleased to review the possible use of a trust in meeting your family's financial planning objectives.

For more information on family trusts or any other taxation matters, please contact us at 780.424.3000, info@krpgroup.com or visit our website @ www.krpgroup.com

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