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Declining costs make trusts more accessible

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Canadian families looking for flexibility in tax and estate planning often set up trusts. Under the right conditions, they can provide controlled distribution of an estate. Trusts have traditionally been viewed as planning tools for the rich, but are now much more accessible and rapidly gaining wider popularity.

A trust is a legal relationship between three parties. The person who sets up the trust is the settlor; the person or group of people who have legal title over the property held in the trust are the trustees; and the parties who will benefit from the property held in the trust are the beneficiaries.

Family trusts are generally set up as either testamentary or inter-vivos trusts. Testamentary trusts come into effect on the death of the settlor, and the trustee manages the assets in accordance with the wishes of the deceased. Inter-vivos trusts are in effect during the settlor's lifetime, and are generally used to transfer assets to heirs over a period of time while retaining control. Inter-vivos trusts are generally taxed at the top marginal rate and testamentary trusts as individuals.

Trusts can be structured so that assets are administered in a fashion most suitable to the beneficiaries. Families whose children are still dependent, either through age or disability, will establish trusts that ensure their children's future financial needs are met. Likewise, those worried about the financial responsibility of their beneficiaries may establish trusts that ensure assets are not squandered.

Trusts can allow for some degree of protection from creditors. The assets held inside a trust are generally protected from claims of creditors against the settlor because beneficial ownership of the assets has shifted to others. Trusts are even useful to protect assets from division of property issues in the event of marital breakdown.

Many families enjoy the confidentiality that comes with trusts. Unlike wills, trusts are private documents and are not a matter of public record. Aside from regular tax returns, trusts are not required to disclose publicly either the assets held in the trust or the beneficiaries.

As a tax-planning tool, inter-vivos trusts can be used to split income. Trust income distributed to beneficiaries is taxed in their hands at a lower marginal tax rate. Be particularly mindful of the kiddie tax, attribution rules, and the 21-year deemed disposition rule. They can be quite complex and professional advice should be sought.

Inter vivos trusts may be revocable or irrevocable. Therefore, since family situations can fluctuate over time and you may want to change your mind, all possible scenarios should be considered fully.

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Trusts can be used to reduce tax liabilities on death. Probate fees are minimized because the trust assets do not pass through a will on death. Also, assets that are transferred to a trust effectively reduce the size of one's individual estate, in turn reducing taxes.

Small business owners can use family trusts to take advantage of the $750,000 lifetime Capital Gain Exemption on Qualified Small Business Corporation Shares upon the sale of the shares of the company. When properly structured, it's possible to multiply the exemption by the number of beneficiaries comprising the family trust. For instance, if the Qualified Small Business Corporation is sold for $4.5 million and there are three beneficiaries in the trust, they will have tax-free capital gains (3 x $750,000).

Trusts have many benefits but they aren't appropriate for everyone. Their structures can be quite complex, so it's important to fully understand them before establishing one. When considering trusts as a part of tax planning, it's essential they are properly set up and administered, or tax benefits may be lost. Costs, both establishment and ongoing administration, should be analyzed relative to your long-term goals.

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