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What is a Trust?

A Trust is created when a person (the settlor) legally transfers assets or property to another person (the trustee) with instructions as to how to use the assets or property to benefit an individual or group of people known as the beneficiary or beneficiaries. Although the trustee holds the legal title to the assets or property, the beneficiaries have beneficial ownership meaning that the beneficiaries actually own the property. Trusts can be used to avoid probate as a Trust bypasses your estate and is not included in the probate process.

Types of Trusts

There are two main types of Trusts. The first is known as a Living Trust or inter vivos trust, which is created while you are still alive. A living trust takes effect once the trust agreement has been signed and the trust has been funded. The second is a Testamentary Trust, which is created by the terms of a persons will. A Testamentary Trust will take life at the time of ones passing away and will be funded by the deceased's estate.

Living Trusts

- Family Trust – A family Trust can be very useful for holding assets or investments to later benefit your children or other dependants. For example, you could create a family Trust that will be used to fund your children's education. If this Trust is designed properly it can provide significant tax savings over the years because your children will be taxed on the capital gains at lower tax rates than you would be taxed at.

- Joint Partner Trust – If you are 65 or older and are planning on leaving your property and assets to your spouse you have the option of transferring your assets into a joint partner Trust. While you are alive you will still have use of your assets and will continue to receive income or capital gains on the assets in the Trust. At your time of death your assets held by your joint partner Trust will pass to your spouse under the terms of the Trust, not the terms of your Will.

- Alter Ego Trust – Similar to a joint partner Trust, an alter ego Trust is for people who are 65 or older but do not have a spouse. At the time of death your assets would be disposed of at fair market value for capital gains tax purposes just like your assets would be disposed of if you did not have a Trust. Benefits of an alter ego Trust include avoiding probate fees, preserving secrecy regarding your level of net worth and how your estate is to be distributed after your death as well as avoiding the requirement to file a list of assets you are passing to your beneficiaries.

- Providing for Family Members – If you have a family members who cannot look after themselves you can create a Living Trust that will provide for their financial needs. When the beneficiary passes away the funds left in the Trust can be passed on to other family members or used for another purpose such as charity.

- Retirement Needs – With age, many people do not feel comfortable managing their finances and look to Trust companies. The Trust can be structured to provide parents with income until the passing of the second parent then the funds left in the Trust can be distributed to children or other beneficiaries.

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Testamentary Trusts

- Spousal Trust – If a spouse is ill or lacks financial responsibility you can create a Trust that will provide income to your spouse until he or she passes away. On the passing of your spouse the remainder of the Trust can be left to children, grandchildren or even a charity.

- Trust for Minors – Common practice is to have provisions setup for children in the case that both parents die. A Trust can be created so that in the case of both parents passing away the trustee can pay out income for the specific needs of the children and/or have the funds dispersed at various times in the child's life.

- Spendthrift Trust – If you have a financially irresponsible child, a solution would be to set up a spendthrift Trust. This gives the trustees power to distribute reasonable amounts of income to the child with excess income being reinvested in the Trust.

- Special Needs Trust – If you have a family members who are mentally or physically challenged, you can create a Trust that will provide for their financial needs. Your family member would be looked after from the interest on the capital of the Trust. Any excess interest would be reinvested into the Trust.

- International Trust – If you have close family members that live outside of Canada or will be receiving money from close family members outside of Canada you can create an international Trust that will provide tax-sheltered/tax-favoured inheritances or gifts from non-residents of Canada.

When Should I Create a Trust?

The best time to create a Trust is now. You can only prepare and implement a trust while you are alive and mentally capable of doing so. If you become unable to manage your affairs or suffer from a disability that hinders your legal capacity, then you will be unable to create a Trust. A Trust can be challenged by those who know you lacked capacity at the time the Trust documents were created.

Who Should Have a Trust?

Not everyone needs to have a Trust. Here are some indicators that should spur you to seek legal advice regarding Trusts.

- You are the parent of a minor.

- Your business and family privacy are important to you.

- You own real estate.

- Your estate has a gross value of $1,000,000 or greater.

- You wish to avoid probate.

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Tax Implications

For income tax purposes a Trust is considered to be an individual. Income and capital gains must be calculated for a Trust just as it would be calculated for a person, however trusts are not allowed to claim personal tax credits.

For a Testamentary Trust, federal income tax is calculated based on the same graduated tax rate schedule that applies to real people. The provincial income tax will be a fixed percentage based on the federal tax amount. The provincial income tax rate will depend on the province in which the Trust is resident. In most cases this will be the province in which the trustee or majority of trustees reside.

A Living Trust will have a combined federal and provincial tax rate of close to 50% depending on the province of residence.

The information provided in this document is not intended to be legal advice but rather to provide answers to a number of questions that we are commonly asked. If you have other questions, please call us and one of our lawyers or experienced staff will be happy to help you.