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# A Primer on Trusts

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Presented by:

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# Agenda



- What is a trust?
- Three common types of trusts:
  - Testamentary Trusts
  - Alter Ego / Joint Partner Trusts
  - Family Trusts

# What is a Trust?

- A trust arises whenever one person gives an asset to another to hold for the benefit of a third person.
- A trust is the relationship between the person who sets it up (the "**settlor**"), the person who manages the trust property (the "**trustee**") and the person who benefits from the trust settlement (the "**beneficiary**").
- A trust can be verbal ("Here, look after this and give it to my daughter on her 16<sup>th</sup> birthday") or it can be in writing.

# Testamentary Trusts

- **Testamentary Trust:** a trust that takes effect after the creator of the trust has passed away. It is most commonly created by a Will.
- **Common Use:** an important tool to protect minor beneficiaries, disabled beneficiaries, spendthrifts and beneficiaries with substance abuse issues.
- **Creative Use:** consider using for other beneficiaries (i.e. your adult children who do not otherwise fit in the above-noted categories). The benefits can include:
  - Creditor protection
  - Flexibility and control
  - Family income splitting opportunities (i.e. tax savings)
  - Reduction of future probate fees upon later deaths of the adult children

# Issues with Wills

- **Probate**
  - Survivors may not have access to most of the property or assets during the probate process which could last 9 to 12 months or longer.
  - Fees payable (legal, executor, accounting and probate). Probate fees are 0.6% for assets worth \$25-50,000 and 1.4% for assets above \$50,000.
  - Privacy is compromised.
- **Wills Variation**
  - In BC, pursuant to the provisions of the *Wills, Estates and Succession Act* (“**WESA**”), any “spouse” or child (natural/adopted) can apply to vary your Will within 180 days of probate issuing if he or she is unhappy with his or her share under your Will.
  - Increases legal costs.
  - Freezes the estate assets.
  - Uncertainty → your wishes may not govern.

**If you are concerned with these issues, you may consider using an inter vivos trust.**

# NUTS AND BOLTS: Alter Ego and Joint Partner Trusts

- ***Inter vivos* trusts** (i.e. trusts created in your lifetime)
- **Alter Ego Trust (“AET”) vs. Joint Partner Trust (“JPT”):**
  - the same thing except that:
    - an AET is for the benefit of you alone
    - a JPT is for the benefit of you and your spouse until the last of you passes away
- **Requirements to create a JPT/AET:**
  - be 65+
  - be a Canadian resident
- **Tax notables:**
  - all *inter vivos* trusts are taxed at the highest marginal tax rate
  - no capital gains are payable on the transfer of assets to a JPT/AET
  - property transfer tax may apply to real estate

# JPTs and AETs: Requirements of Use

- **Income Payment Requirement:**
  - Income earned on the trust's assets during each year must be paid to you (AET) (or you and/or your spouse if a JPT)
- **Capital Distribution Requirement:**
  - Any capital paid out/used must only be used for the benefit of you (and your spouse if a JPT)
  - So, for example, if you want to give assets to a child:

Trust → Self → Child

NOT

Trust → Child

# JPTs and AETs: Will Substitutes

- **Distribution on Death:**
  - The trust will include terms on how the assets will be distributed when you (or you and your spouse if a JPT) pass, just as in a Will
- **JPT/AET vs. a Will:**
  - Assets in the JPT/AET are not subject to Wills Variation proceedings under WESA
  - Assets in the JPT/AET are not subject to probate fees (1.4%)
  - WESA's required holding period prior to distribution of assets does not apply
  - A private matter (unlike the public probate process)
  - Planning option where imminent incapability

# JPTs and AETs – Practice Tips

- If you are already in the highest tax bracket, no impact on annual tax rate
- Great tool if you are concerned about:
  - wills variation
  - probate fees (\$14,000 / \$1M of probated assets) – the probate fee savings can often offset the set up and maintenance costs of the JPT/AET
- Can be an **over-solution** if:
  - no wills variation issue and the costs of setting it up and administering it exceed the probate fee savings

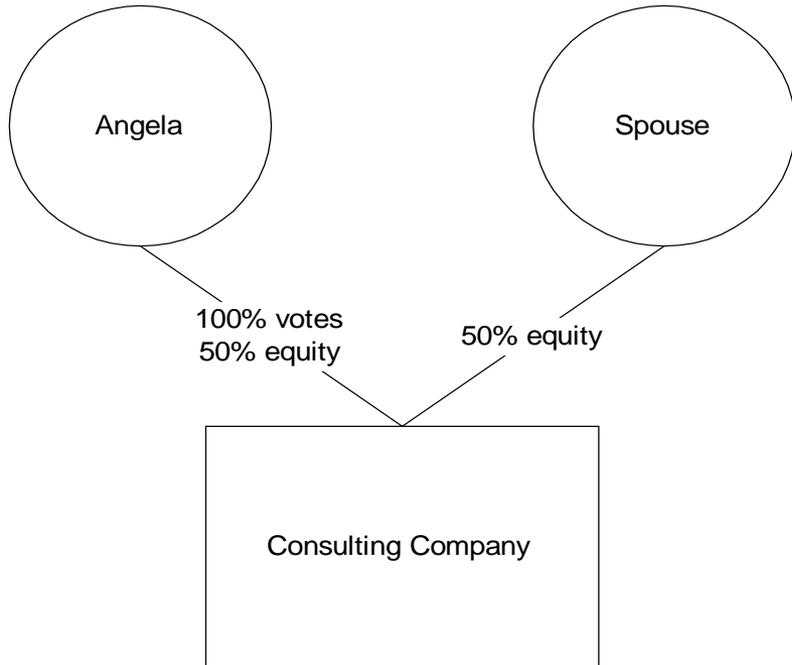


# Family Trusts and Companies

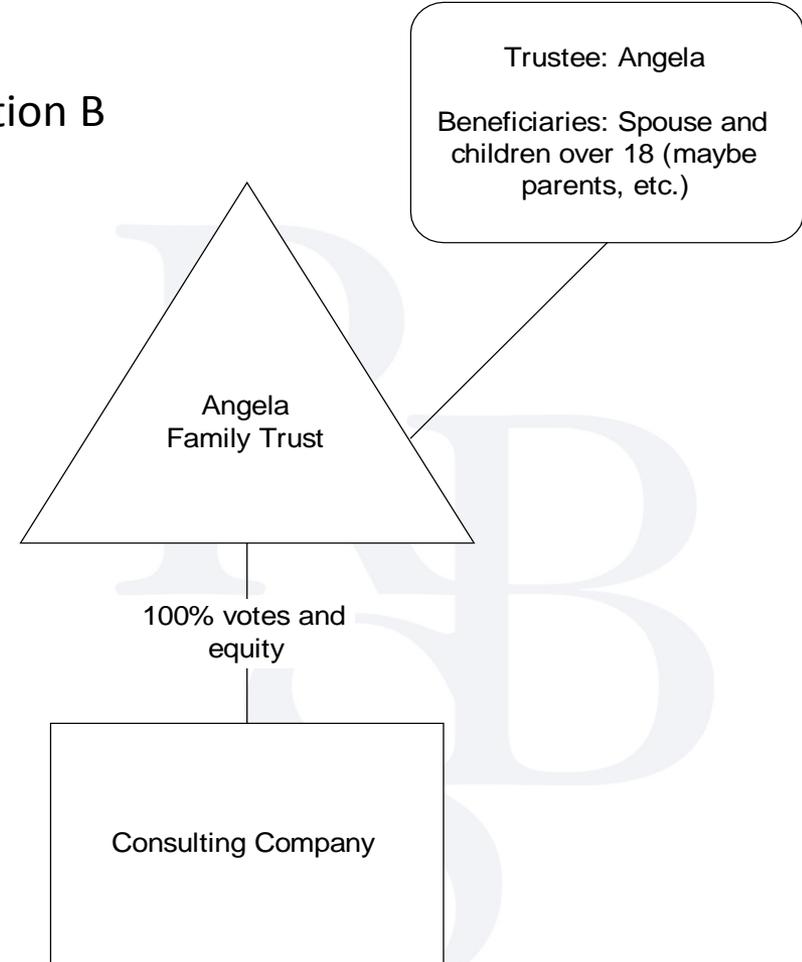
- **Family Trust:** a form of *inter vivos* trust
- **Common Uses:**
  - as the initial equity shareholder in a company to allow for income splitting and stacking of the capital gains exemption
  - in conjunction with business succession planning where the family trust becomes a shareholder later (more on this to follow)

# Incorporation: Two Basic Options

Option A



Option B



# Discretionary Family Trusts as Shareholders

## – Benefits:

- Income splitting amongst beneficiaries of trust (usually family members over 18 years of age or other companies)
- Retaining control as trustee
- Family law protection
- Creditor protection
- Probate fee management
- Wills variation management

## – Beware:

- Attribution rules
- Costs of creating and administering
- 21 year lifecycle – the “deemed disposition” rule
- Americans



# Freezing Existing Companies – Business Succession and Estate Planning

- **Purpose**

- Redirecting future growth
- Generational succession / employees becoming owners
- Capital gains and probate fee planning

- **Freeze**

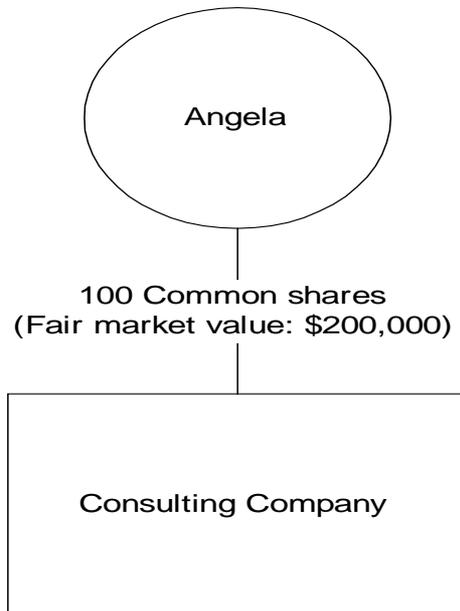
- ‘Freezing’ current value of a company by exchanging the current common shares for preferred shares with the equivalent fair market value
- Allows new key people (next generation, family trust, employees, etc.) to buy shares for nominal value that will hold future growth

- **Wasting Freeze**

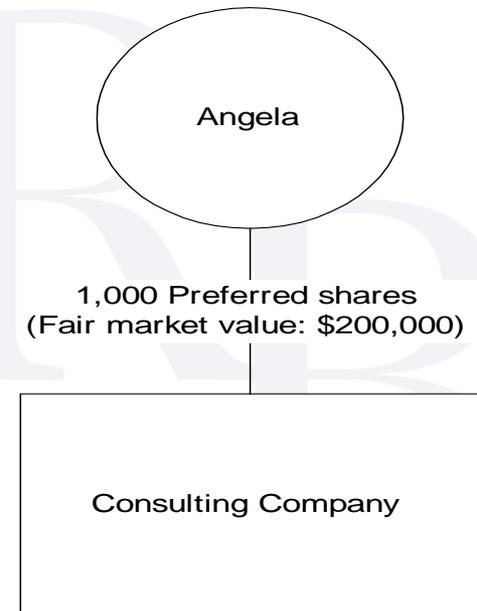
- Redeeming those preferred shares over time so that there are no/nominal shares personally owned on death – and therefore – no/nominal value on which capital gains can be taxed on death

# Freeze: Basic Example

## Existing

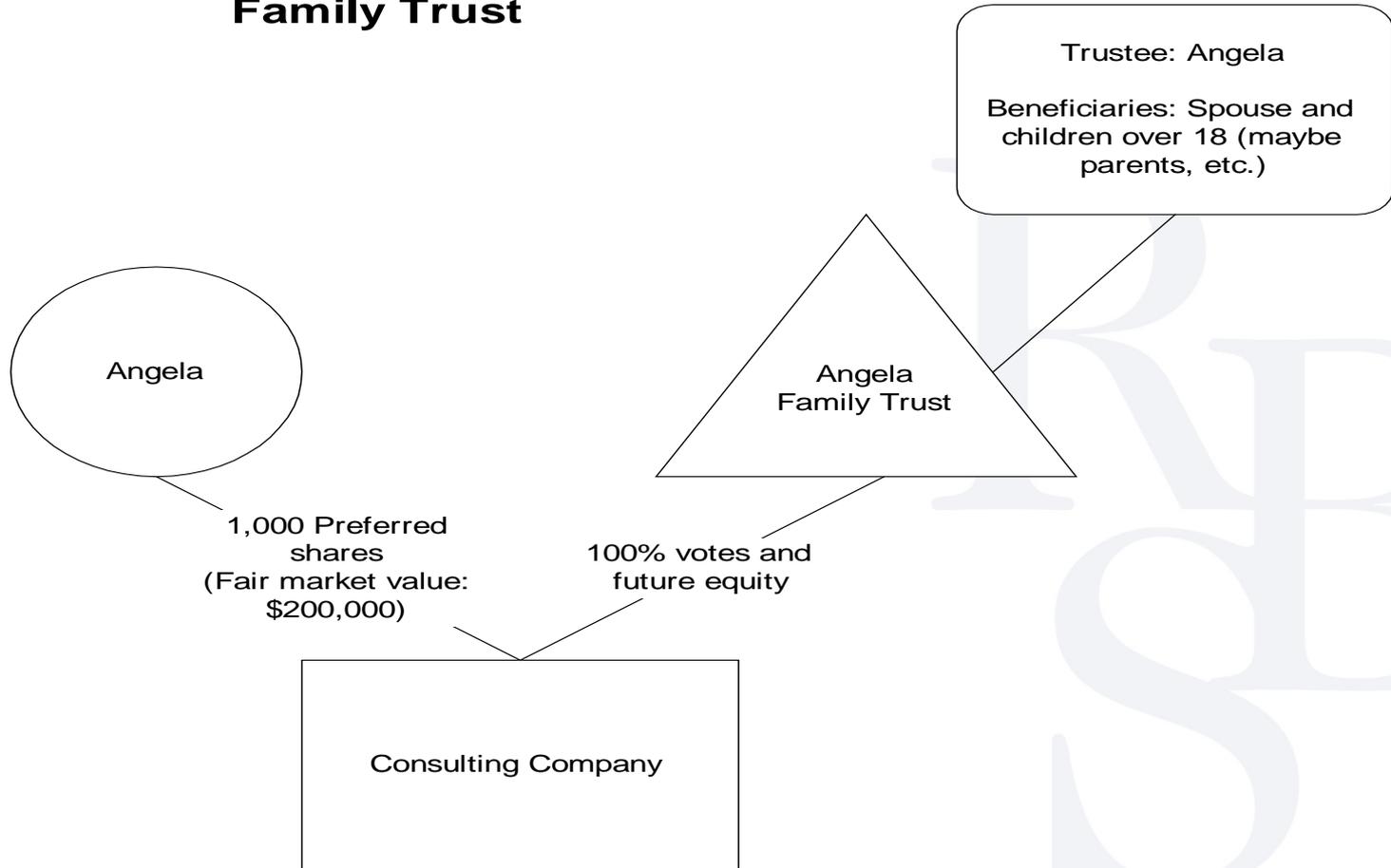


## Step 1: Freeze



# Freeze: Basic Example

## Step 2: Introduce Family Trust





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