A Primer on Trusts

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Presented by:
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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 16th 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
• **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:

  ![Diagram](image.png)

  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 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

- Angela
  - 100% votes
  - 50% equity

- Spouse
  - 50% equity

Consulting Company

Option B

- Angela Family Trust
  - Trustee: Angela
  - Beneficiaries: Spouse and children over 18 (maybe parents, etc.)

Consulting Company

100% votes and equity
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**

- Angela
- 100 Common shares (Fair market value: $200,000)
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**Step 1: Freeze**

- Angela
- 1,000 Preferred shares (Fair market value: $200,000)
- Consulting Company
Step 2: Introduce Family Trust

Trustee: Angela
Beneficiaries: Spouse and children over 18 (maybe parents, etc.)

Angela Family Trust

1,000 Preferred shares (Fair market value: $200,000)
100% votes and future equity

Consulting Company
For further information and inquiries contact:

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