What Is A Trust And How Does It Work?

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First of all, what is a trust? A trust is an arrangement between the person who creates the trust by contributing property (the settlor) and the person who manages the trust property (the trustee(s)) to provide benefits for entities identified by the settlor (the beneficiaries). A trust deed documents the arrangement, outlining the "rules" the trustee is to follow. If the trust is created while the settlor is alive, we refer to this trust as an *inter-vivos trust*.

People often use an inter-vivos discretionary family trust (DFT) in their **estate planning.** If properly structured, the DFT can provide owner-managers flexibility while retaining control. The trust's discretionary nature permits the trustee(s) to determine the appropriate allocation of income or capital from the DFT to its beneficiaries[i].

Attributes of a DFT include the following:

- The DFT will have a December 31st year-end and is taxed at the top marginal tax rate for individuals. The DFT can claim a deduction for income paid or payable to beneficiaries.
- Generally speaking, income that is retained and taxed in the DFT becomes the trust's capital and in most cases can be distributed to beneficiaries on a tax-free basis.
- In order to prevent the deferral on the inherent gains of the property held by the DFT, every 21 years the DFT is deemed to dispose of all its property at fair market value and reacquire the property at this value. Unless this is appropriately planned for, a significant tax liability may occur on every 21st anniversary of the trust.
- The DFT provides the ability to utilize the marginal tax rates of beneficiaries[ii].
- Beneficiaries of the DFT should not incur a tax liability on this interest at the time of their death.

If the DFT holds non-voting, participating common shares of a company, it can provide the following benefits:

- Trustees will not have any direct involvement in the operations of the company. The trustees will only be required to make decisions related to the income received by the DFT.
- The DFT provides trustees with the ability to postpone (for up to 21 years) the decision as to who the successor shareholder(s) of the company will be, while providing the ability to allocate the current growth in these shares to the successor(s).
- Non-eligible dividends of approximately $40,000 can be distributed to some adult beneficiaries with no other income without being subject to income tax. This provides a tax savings of approximately $15,000 when compared to the tax paid if the dividend was received by someone

in the top marginal tax bracket in B.C. If the trust receives and distributes eligible dividends the tax savings are even higher.

- The DFT can allocate the capital gain on a disposition of shares of a Qualified Small Business Corporation (QSBC)[iii] to multiple beneficiaries. This allows the capital gain to be sheltered by more than one capital gains exemption ("CGE")[iv].

- A DFT can be put into place to keep a Company "pure" for QSBC purposes.

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[1] Within the limitations outlined in the trust deed.
[2] Subject to the attribution rules in the *Income Tax Act*.
[3] In general, a QSBC is a corporation where the assets are primarily used in an active business carried on in Canada.
[4] Currently at $813,600, indexed for inflation.