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Why trust funds aren't just for royalty or the rich and famous

By Jason Heath

Trusts can be useful wealth management tools, and you don't have to be a billionaire to justify the costs or reap the benefits

Most people think that trust funds are for Hollywood heiresses and British royalty. But many much more average Canadians can benefit from including trusts in their wealth management plans.

Trusts are a relationship between a settlor, trustee and beneficiary. They are established when a settlor transfers an asset to a trustee to manage on behalf of a beneficiary. For example, a grandparent may settle a trust with money to be invested by their trustee child for their grandchildren beneficiaries.

Trust deeds prepared by lawyers are generally used to document a trust. Initial legal fees to establish a trust may cost a few thousand dollars and annual tax filings may cost a few hundred dollars. In many cases, the costs are worth the benefits.

Family trusts are probably the most common example, often implemented by high-income earners to split income with family members. A family trust is a trust where all beneficiaries are family members. By placing assets into a trust for the benefit of family members, the income generated can be paid to or on behalf of them and taxed in their hands at lower tax rates. A family trust can pay for expenses like private school tuition, sports activities and gifts, for example.

The income generated from even $100,000 of investments could result in annual tax savings into the thousands, though family trusts are often established with much larger amounts to ensure the benefits outweigh the costs.

Trusts are sometimes used by parents to pass down the family cottage. They can be effective to protect children from having their share subject to division in the event of a marriage breakdown.

A $1 million cottage owned by two children could expose $500,000 each to division in a divorce. By using a discretionary trust and naming the two children who both have three children of their own as beneficiaries, an ex-spouse may only have a claim on 1/8 of the cottage – so $125,000 instead of $500,000. A divorcing child's interest could possibly be valued at as little as nil instead of $500,000 and avoid a potential $250,000 equalization payment.

Trusts can also be used by business owners to pass along future business growth to other family members. This can result in tax savings of over $250,000 per person, specifically for qualified farms or small businesses eligible for a tax-free capital gains exemption that can be earned by multiple family members.

Given that the exemption for small businesses is $824,176 for 2016 and $1 million for qualified farms, even those who own a company or farm worth under $1 million should consider the benefits of a trust.

Alter ego and joint partner trusts can be used by Canadians over age 65 to hold assets that can bypass provincial probate fees on death. Depending on the province of residence, these trusts can save over 1.5 per cent of the estate value ($15,000 on $1 million of assets). In cities like Toronto and Vancouver, it is not uncommon for people to be millionaires simply by virtue of their home value.

A spousal trust established on death can be an effective way to provide financially for your surviving spouse – in particular, in a second marriage – while also ensuring that some or all of the trust capital goes to your children.

Trusts can be useful wealth management tools, especially for tax and estate purposes. You do not have to be a billionaire to justify the costs or reap the benefits – so be sure to ask your lawyer or accountant if they might just be right for you.

Illustration by Chloe Cushman/National Post

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Jason Heath is a fee-only Certified Financial Planner (CFP) and income tax professional for Objective Financial Partners Inc. in Toronto