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How Changes to the Taxation of Trusts may Impact You

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Are you thinking about your estate plan and have one or more of these situations to consider?

- Your intended beneficiaries may be minors or younger adults who would not be able to manage significant amounts of money or property on their own.
- One of your beneficiaries may be disabled.
- You may be concerned about leaving property outright to your surviving spouse for fear that they will remarry and ultimately pass the property to their new spouse. Alternatively, they may have children from a previous marriage who might inherit property at the expense of your own family members.
- You want to protect your children from a future matrimonial claim.

If any of these common situations apply to you, then there may be a need for a trust.

What are trusts intended for?

Trusts can be used in a variety of ways to enable you to achieve your estate planning objectives. You can establish a trust to hold the property on behalf of your intended beneficiaries. Trust assets would be managed, and income and capital would be distributed, in accordance with directions provided in the trust agreement or will, as the case may be. Life insurance is frequently used as a means of funding a trust.

Although the tax rules for trusts are obviously important, there is sometimes a misconception that trusts are established primarily as tax saving vehicles. In fact, while trusts can be used quite effectively for tax-planning purposes, they were developed long before our income tax system was developed. While these vehicles do have their tax advantages, in most cases income tax is a secondary consideration in the creation of a trust. Most often, the need for a trust will arise if you wish to provide a gift to one or more beneficiaries, but wish to control how that gift is used.

How might changes to the taxation of trusts impact you?

Significant changes to the taxation of testamentary trusts (trusts established on a person's death) were enacted in December 2014 and became effective on January 1, 2016. The new legislation has a profound impact on estate and will planning generally, but also has specific implications in areas such as charitable giving, planning for disabled beneficiaries, post mortem tax planning for shareholders in private corporations and life insurance planning. There is no grandfathering for trust arrangements in existence prior to 2016.

Since Canadian tax reform in 1971, income earned in a testamentary trust has been taxed at the same marginal rates that apply to individual taxpayers, while income earned in an inter vivos trust (a trust established during a person's lifetime) is taxed at the top marginal rate. Under the new rules, testamentary trusts will fall under the same rules that apply to inter vivos trusts unless they are graduated rate estates (GREs) or qualified disability trusts (QDTs). For the most part, income from any type of trust that is distributed to a beneficiary will be taxed at the beneficiary's personal marginal rate.

What is a Graduated Rate Estate? – A GRE is an estate arising on an individual's death and may exist for up to thirty-six months thereafter. The estate must be a testamentary trust and designate itself as a GRE in its tax return for its first year ending after 2015. Only one GRE per deceased person is permitted. Where the estate is a GRE it will have access to marginal tax rates in the same way that has always been available to testamentary trusts.

What is a Qualified Disability Trust? – A QDT is a trust under which at least one beneficiary qualifies for the disability tax credit. It has many of the same tax advantages as a GRE.

Trusts can play a key role in estate planning. This will continue to be the case despite ongoing tax changes. Your advisor can help you determine what's best for your specific situation. To discuss your options, contact them today.

More indepth information on trusts can be found in the 6th edition of Estate Planning with Life Insurance, by Glenn Stephens, released November 2016.