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TAX MATTERS

Things you should know about in-trust-for accounts

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"Dad, I want to become a wild turkey trainer," my son, Michael, declared this week. Turns out he read about Gerald, a wild turkey in Oakland's Grand Lake neighbourhood. Gerald lines up with carpool riders near Morcom Rose Garden but has recently turned nasty and has started clawing and pecking people as they run from him. Animal control officers have asked people not to feed him and are trying to train him to return to natural behaviours and may relocate him. It appears that wild turkeys can be a problem.

Look, I just want my children to be successful in whatever they pursue. What does this look like? It's different for everyone, but a postsecondary education, eventual home ownership and perhaps starting a business are things my children are thinking about. These things all cost money. Many Canadians have turned to "in-trust-for" accounts or ITFAs to help save money for their children – often for an education, but for other reasons as well.

Today, I want to share a primer on ITFAs. Call this ITFA 101.

THE DEFINITION

An ITFA is an investment account (sometimes a bank account) that typically a parent or grandparent will set up for a minor child. There is a contributor to the account (usually the parent or grandparent) and a beneficiary (the child) who is the ultimate owner of the funds in the account. The account is typically in the name of the adult, "in-trust-for" the minor child. Generally, minors can't open investment accounts on their own, so in-trust accounts can solve this problem.

The adult whose name is on the account is considered to be the "trustee" who will make the investment decisions and can make withdrawals from the account – although there's a legal responsibility to make withdrawals for the benefit of the beneficiary, and not for other purposes. Once the minor child reaches the age of majority in their province, they become legally entitled to control over the

account and the funds, along with the original trustee. The expectation is that the trustee will eventually transfer control of the account to the beneficiary entirely.

THE BENEFITS

Why do folks set up ITFAs? Generally, because they want funds earmarked for the benefit of the child that can face tax in the child's hands over the years, rather than being taxed in the hands of the parent or grandparent. Basically, the intention is to establish a trust for the child without the hassle of setting up a formal trust, which requires a written trust agreement – and generally legal fees.

With an ITFA, there is no limit on how much can be contributed to the account, unlike a registered education savings plan, which has a $50,000 lifetime limit. (I'm not criticizing RESPs; there are definite benefits to those plans, including grants from the government to help save for a postsecondary education.)

Further, the funds in an ITFA can be used for any purpose, not just an education. It's also quite easy for your minor child to gain access to the funds once they have reached age of majority (some view this as a drawback).

THE TAXATION

As the funds in the ITFA earn income and grow in value, any capital gains can be taxed in the hands of the child, rather than facing tax in the adult contributor's hands. Unfortunately, this is not true of interest or dividend income, which will be attributed back to the parent or grandparent making the contributions to the account. By the way, if the funds in the ITFA come solely from the Canada child benefit or an inheritance from a deceased adult, all of the income in the account will be taxed in the child's hands.

THE LIMITATIONS

There are limitations to ITFAs to be aware of. First, you won't be able to prevent your child from eventually taking the money and running. You see, there's a legal case known as Saunders v. Vautier, which established that this type of trust can be wound up if the beneficiaries demand it, are of sound mind and have reached the age of majority.

Next, you can't reallocate funds between beneficiaries if you set up an account for each child separately. Each child is entitled to their specific funds. Even if you've named more than one beneficiary on a single account, you can't arbitrarily change the percentages that each is entitled to receive.

Finally, if one spouse is named as trustee over the account, and the marriage fails, the other spouse may not gain control over the funds in the account, even upon the death of the trustee.

Today, I have scratched the surface of ITFAs. Next week, we'll go a little deeper: ITFA 201.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc.