CESTNICK

TAX MATTERS

Seven reasons to use a family trust

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED SEPTEMBER 29, 2022

My son, Michael, is taking a personal finance course at university. One assignment has asked the students to discuss approaches to paying for their entertainment costs while at school full-time. Not to help my son with his assignment here, but the way I see it, students have eight options for finding the money – and most try it in this order: Ask parents, ask friends, try crowdfunding, inherit money, take from a family trust, tap into savings, get a job or rob a bank (a bad idea).

Yes, providing children with spending money is just one use of a family trust. Last week, I introduced the concept of trusts, and today I want to talk about seven reasons why you might consider setting one up.

Minimize taxes on death. Upon death you'll be deemed to have sold most of what you own, which can give rise to taxes if those assets have appreciated in value. If you transfer assets to a trust, the future growth of those assets won't belong to you directly, so you'll avoid tax on death on the growth in the trust. An "estate freeze" is one way to accomplish this by, most commonly, transferring certain growth assets to a corporation. In exchange, the corporation will issue special shares to you, which are frozen in value. This can generally be done without paying taxes today. Then, common shares in the corporation will be issued to a trust. As the assets in the corporation grow in value, so do the common shares owned by the trust, but you won't face tax on death on those shares owned by the trust.

Split income with others. It's possible to lend money to a trust that you set up. The trust can invest those funds and earn income. If you charge the prescribed rate of interest on the loan (you'll be taxed annually on this interest, which must be paid by Jan. 30 for the prior year's interest charge), then any income earned by the trust can be taxed in the hands of the beneficiaries, who might pay little or no tax if they're in a low tax bracket.

Pay expenses for beneficiaries. This is an extension of the last idea. As the trust earns income, you don't have to actually distribute the income out of the trust to the beneficiaries each year – although they'll eventually have a right to those dollars if they've been taxed on the income. The good news? You don't have to pay the income directly to the beneficiaries, but rather you can use the

funds for their benefit by paying for things like travel costs, summer camp, a computer, vehicle, wedding, a down payment on a home, and more. Since the income will have likely faced little or no tax, you'll effectively be paying for these things using pretax dollars.

Save for a child's education. A trust can be used to pay for a child's education. If you lend money to the trust (see my comments about splitting income above), you can earn income in the trust and, unlike a registered education savings plan, can use those earnings to pay for any level of schooling – not just postsecondary school. The income of the trust can be taxed in the hands of the child whose tuition you're paying.

Multiply the capital gains exemption. A trust can hold shares in a private corporation. If those shares are "qualified small-business corporation shares" then it may be possible to shelter capital gains on the shares by using the lifetime capital gains exemptions of the beneficiaries. The LCGE can shelter up to $913,630 (in 2022) in capital gains per beneficiary.

Protect assets from others. Assets that are held in a trust can often be protected from creditors who may go after your assets. There may be some exceptions to this if, for example, you transfer assets to a trust in contemplation of declaring bankruptcy or getting divorced. Speak to a lawyer about what protection a trust can offer.

Maintain control while changing ownership. You can provide beneficial ownership of assets to others by naming them as beneficiaries of a trust to which you transfer the assets. But you can still maintain control if you're a trustee with powers to determine what's done with the assets. This is common when a business owner wants to bring his or her children into the business as owners but isn't ready just yet to hand voting control to them. Simply transferring assets to a trust can create a tax bill since you'll be deemed to have sold the assets at fair market value on the transfer, but there are ways around this (by completing a freeze, for example, which I talked about earlier).

There are more reasons to set up a trust, so I'll continue the conversation next time.

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