Trusts

By M. D. Fairhall FCGA

Trusts: A brief overview of how they work and how they can be useful for individuals with disabilities.

This article is written for the general reader. Since some jargon is unavoidable, a glossary of terms is provided.

What is a trust?

A trust is a written agreement between a settlor (the person who establishes it) and the trustee (the person who manages the assets in it) for the benefit of other persons (the beneficiaries).

How can it be used?

Some circumstances where a trust is useful are set out below:

a) Where an adult beneficiary requires institutional living arrangements, the cost of which is income tested, the trust income and capital can be kept out of the individual's income for means test purposes. The BC "Employment & Assistance for Persons with Disabilities Act" and regulations thereto provide a complex set of rules used to determine provincial benefits.
b) To provide security and peace of mind for elderly parents of a disabled adult by ensuring continued care after the parents are deceased or otherwise unable to provide it at home.
c) Where there is a concern that the beneficiary is, or may become, financially irresponsible.
d) To avoid potential challenges to a parent's will, which can arise under The Wills Variations Act, by making provision for the disabled individual outside the will.
e) To prevent possible involvement of the Public Guardian & Trustee in the disabled individual's affairs.

Types of trusts:

In this article I deal with two types only.

a) Testamentary, which arises from an individual's will.

And

b) Inter vivos , which is among living persons.

a) A testamentary trust is created by an individual's will on the date of death. It can provide for one or more trustees who will likely be different from the executor of the will. The assets of the trust would be whatever bequest was provided to the beneficiary in trust in the will. Possible concerns with testamentary trusts for disabled beneficiaries include funding not being available at the date of death, and that the caregiver parent may cease to be able to provide care long before dying.

b) An inter vivos trust can address some (most?) of the concerns with testamentary trusts for disabled individuals. The immediate effect of such a trust provides greater certainty as to care and funding being available.

Costs:

The initial set up of a trust will cost several thousand dollars in legal fees. If a non-family trustee is involved, there will be ongoing trustee fees to be paid. There will also be bookkeeping and tax filings required. The rules are quite complex and the costs can be much greater than for an individual's personal tax return.

Taxation of trusts:

This is a complicated area which requires ongoing professional attention. The present rules tax the income of Testamentary trusts at the graduated rates applicable to individuals. Inter vivos trusts are taxed at the top marginal rate on all taxable income of the trust.

In both cases trustees and their advisors can pass income from the trust to one or more beneficiaries, and thus move the taxation of that income to the beneficiary who may have low income and be non-taxable.

The government is presently reviewing these rules and its' intention is to restrict the graduated rates on testamentary trusts to a three year period following the death. The new rules are expected to come into effect in 2016.

The Income Tax Act provides for a preferred beneficiary election which allows the tax consequences to be in the hands of the beneficiary while the income remains in the trust. The trustee can then make non-taxable capital distributions in order to meet the needs of the preferred beneficiary. A preferred beneficiary for this purpose is an individual qualifying for the disability credit under The Income Tax Act.

If you have read this far you will have a sense of the complexity involved. There are many specific factual circumstances which will influence a decision on whether to implement a trust plan.

Lawyers who set these up will usually provide a check list to a non-professional trustee such as a family member. This list will set what needs to be done to maintain the trust in good standing with the tax authorities and avoid contravening provincial assistance rules.

GLOSSARY

Beneficiary – A person who is entitled, or may become entitled, to proceeds from a trust or estate

Capital beneficiary – A person who is, or may become entitled to, the assets or of a trust or estate. This person may be different from an income beneficiary.

Executor – The person named to deal with an estate by an individual in his will.

Income beneficiary – A person who is, or may become, entitled to the earnings on the assets of an estate or trust. This person may be different from a capital beneficiary.

Individual – A living human being.

Inter vivos – Latin for "among the living". The parties to such a trust do not act as a consequence of someone's death.

Person – Includes individuals, corporations, societies and other entities.

Preferred beneficiary – In an income tax context, an individual entitled to the disability credit.

Settlor – The person who establishes a trust.

Testamentary – Refers to estates, trusts and other matters arising from a will.

Trustee – The person who manages the assets of a trust in accordance with the terms of a trust document.