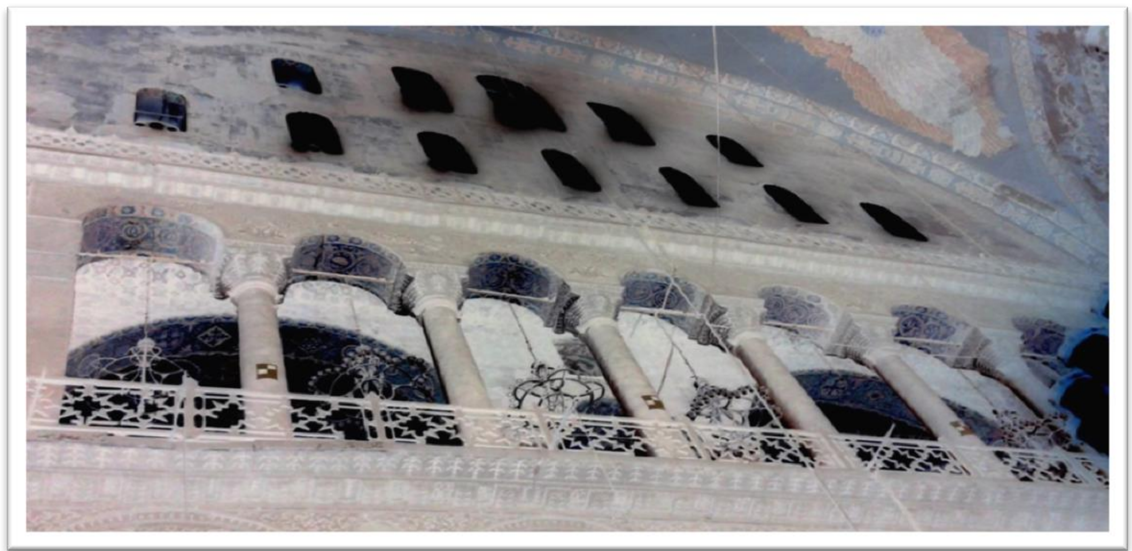

2016: The Dawn of the New Trust Regime

In 2013 the Federal Government announced via the budget, its intention to amend the tax provisions of testamentary trusts. This was followed by the 2014 budget where they proposed a number of changes to the taxation of trusts and estates under the Income Tax Act (ITA) of Canada that would have a significant impact on tax planning. One, being the elimination of graduated-rate taxation in testamentary trusts and two, changes in other tax benefits in spousal trusts, alter ego trusts and joint partner trusts.

Beginning January 1, 2016, income earned and retained by a testamentary trust will be subject to tax at the top flat rate. Spousal trusts, alter ego trusts, and joint partner trusts are subject to a deemed disposition of the capital assets upon the death of the income beneficiary.

This article aims to bring to light that previous financial and succession plans need to be re-visited to ensure original goals and objectives are still attainable with new tax rules in place for trusts.*

BY DEFINITION

To minimize any confusion, let's first identify the types of trusts and trust terms. Based upon the Canada Revenue Agency (CRA) definitions:

A **trust** is a legal relationship between three parties. First the settlor is the person that sets up the trust and contributes assets to it. Second the person or company appointed to administer the trust is the trustee. Third there are the beneficiaries which are the people benefitting from the use of or income from trust assets.

A **testamentary trust** is a trust or estate that is generally created on the day a person dies. All testamentary trusts are personal trusts. The terms of the trust are established by the Will or by court order in relation to the deceased individual's estate under provincial or territorial law.

An **inter-vivos trust** is one created while the settlor is alive to hold property for the benefit of others – usually family members for income splitting and minimizing taxes.

In most cases a **spousal trust** includes both a testamentary trust created after 1971, and an inter-vivos trust created after June 17, 1971. In either case, the living beneficiary spouse or common-law partner is entitled to receive all the income that may arise during the lifetime of the spouse or common-law partner. That spouse or common-law partner is the only person who can receive, or get the use of, any income or capital of the trust during his or her lifetime.

An **alter ego trust** is an inter-vivos trust created after 1999 by a settlor who was 65 years of age or older at the time the trust was created, for which the settlor is entitled to receive all the income that may arise during his or her lifetime, and is the only person who can receive, or get the use of, any income or capital of the trust during the settlor's lifetime. These trusts are used to protect assets from litigation, avoid probate fees, and to replace the need for a power of attorney document in respect to some financial decisions.

A **joint partner trust** is an inter-vivos trust created after 1999 by a settlor who was 65 years of age or older at the time the trust was created. The settlor, and the settlor's spouse or common-law partner, are entitled to receive all the income that may arise from the trust before the later of their deaths. They are the only persons who can receive or get the use of any income or capital of the trust before the later of their deaths.

WHAT IT MEANS FOR YOU

In recognition of the fact that estates require a reasonable period of time for proper administration, the amendments (outlined Budget 2014) will permit an individual's estate that is a testamentary trust (a "graduated rate estate") to continue to access graduated rates for the first 36 months after the individual's death. In addition, the Government has indicated that graduated rates will continue to apply to testamentary trusts with beneficiaries who are eligible to claim the federal disability tax credit.

As you work with a professional to review and update your Will, consider having only one family trust rather than multiple testamentary trusts to reduce administration costs; in light of the loss of graduated rates. Also, consider providing for the administration to last for up to 36 months to benefit from the period of time that graduated rates apply.

Under the changes now in effect (2016), the taxes arising from the deemed disposition of trust property upon the death of the settlor in an alter ego trust will be, treated as the settlor's income in the settlor's year of death, and payable out of the settlor's estate. If there are insufficient funds in the estate, CRA may collect the tax out of the trust property.

In a joint partner trust, the taxes arising from the deemed disposition of the trust property on the death of the last of the spouses to die, will be treated as the income of the last of the spouses to die and will be payable out of his or her estate; unless there are insufficient funds, in which case CRA may collect the tax out of the trust property. These changes bring about a need to revisit tax planning and insurance planning to provide liquidity for tax payment to CRA.

You can begin the process by asking yourself the following questions and partnering with a professional** to assist you:

- What happens to my business assets or my legacy intended for my children should my spouse remarry?
- How do I protect my spouse from blowing his/her inheritance and outliving the assets?
- How do I protect family assets from future litigation?
- Have there been major changes since I last reviewed my Will? Do I need a trust?
- Do I have enough life insurance? Does my spouse?

*This article is general in nature and does not encompass the total scope of the changes in tax treatment of trusts in 2016 and forward.

**The Intueri Group will discuss each situation, customize solutions and make referrals on a case by case basis.

To have a deeper conversation about how this subject will affect you or your business, please contact us directly:

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