THE GLOBE AND MAIL • SATURDAY, FEBRUARY 14, 2015

A tax tool that's not just for trust fund babies

Trusts can help families protect their heirs as well as their assets

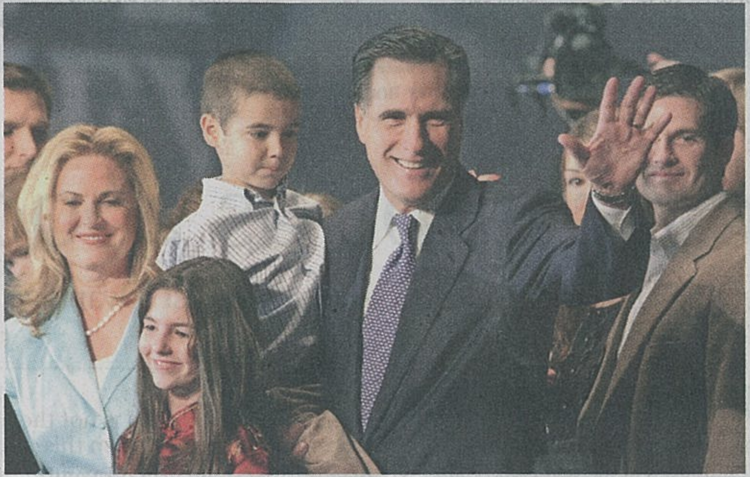
DIANE JERMYN

The word "trust" may bring up images of a tax dodge for the super-rich. This is partly because of prominent U.S. examples. For instance, by setting up a trust for his children and grandchildren, former Republican presidential candidate Mitt Romney was able to avoid paying hefty U.S. gift and estate taxes, and by legally transferring money and assets to family members through a trust, he continues to save a bundle at income-tax time.

But that's not the Canadian way. Estate taxes in the United States can be punitive, up to 40 per cent of the value of an estate, explains Jon Palfrey, senior vice-president, Leith Wheeler Investment Counsel Ltd., in Vancouver. In Canada, estates are taxed on their capital gains, aside from registered accounts, such as RRSPs, which are taxed as income for the estate.

"That's a big difference," says Mr. Palfrey. "Since the stakes are higher when it comes to intergenerational transfers in the U.S., there's more incentive for aggressive estate planning. The planning here is typically more about funding a future tax liability rather than making plans to avoid that liability. That's very Canadian!"

In Canada, people may use trusts to reduce or defer taxes, but the Canada Revenue Agency is vigilant in creating rules to deter abuse and make sure family trusts operate as intended. And trusts are not just for the 1-percenters.



Former U.S. presidential candidate Mitt Romney set up a trust for his children and grandchildren, and was able to avoid paying hefty taxes.
FABRIZIO COSTANTINI/NEW YORK TIMES NEWS SERVICE

U.S. VERSUS CANADA: TAXES ON $10-MILLION ESTATE

Jon Palfrey, senior vice-president, Leith Wheeler Investment Counsel Ltd., in Vancouver, gives examples of how a $10-million estate would, broadly, be taxed.

U.S.
In the United States, if it were passed on to heirs who are not the spouse, the current exemption is $5.3-million and is deducted, so the remaining $4.7-million would attract a federal estate tax of 40 per cent, or $1.88-million.

Canada
For a $10-million estate in Canada going to heirs who are not the spouse, the capital gains would be calculated on the taxable assets, of, say, $5-million of investments that have a book value of $2-million. So, $3-million times 50-per-cent capital gains at a 40-per-cent tax rate would be $600,000. The principal residence is exempt and the RRSP or RRIF of, say, $1-million would be subject to tax of about 40 per cent, or $400,000. That would equal about $1-million in federal and provincial taxes. (There are also probate fees that vary across the country.)

Diane Jermyn

"Trusts and the use of trusts as a vehicle for tax planning are alive and well in Canada," says Toronto tax lawyer Robert Kepes, co-founder and partner, Morris Kepes Winters LLP. "They can be very useful for estate planning purposes, for charitable giving, for getting out from probate taxes or for protection – by providing for family members or to ensure a disabled child, spouse or parent has funds to be cared for properly after you've passed away.

"A trust is just a vehicle that people use for different motivations, including some that have nothing to do with tax. Trusts can also be used for creditor proofing, for instance, if you want your assets owned by someone other than you in case you get sued."

The biggest tax benefits come from income splitting or being able to save on provincial probate taxes. While anti-avoidance rules in Canada stop people from some of the more blatant income splitting, Mr. Kepes says there are acceptable methods of income splitting that you can use a trust for with adult children or spouses.

"With income splitting, what you're trying to do is reduce the high net worth person's income by having some income allocated either directly or indirectly through a trust to someone else in a lower tax bracket," says Mr. Kepes. "Over all, the family ends up paying less tax."

Probate taxes vary a bit from province to province. Ontario charges approximately a 1.5-per-cent tax on the value of an estate upon death. For people older than 65, there are trusts that they can transfer their assets into tax-free. Otherwise, people have to pay taxes at the top rate when they put assets into a family trust.

"It can still be worthwhile, even if you're not in a high net worth bracket," says Mr. Kepes. "If your estate is worth $1-million, the probate tax would be about $14,500. But if you're over 65, there are trusts you can use where you can take your assets and transfer them into that trust tax free. It's a pretty straightforward process. Then, when you pass away, you don't own those assets any more and they wouldn't be subject to probate tax."

Mr. Palfrey sees one of the biggest benefits of trusts as providing the certainty people want to have for either minors, or spendthrift heirs, or for blended families about how an estate will be divided to avoid wills litigation around their estate. But there's a flip side to the specific tax advantages or benefits of a trust.

"There is no silver bullet," says Mr. Palfrey.

"After setting up a trust, there are ongoing costs, plus annual tax filing. Also, tax reductions may be fleeting. The beneficiary in the lower tax bracket may not stay in that lower tax bracket forever, or a tax loophole could end. The CRA is constantly trying to close any loopholes."

Special to The Globe and Mail