Trust

What is a Trust?

- A trust is not a legal entity but a relationship between parties
- It is relationship between:
  - **Settlor**: someone who contributes/transfers property for the benefit of the beneficiaries
  - **Trustees**: someone who looks after the property transferred
  - **Beneficiaries**: person benefiting from the property
- Is not a person at law
- Cannot own property or hold title in its own name
- Wasn’t really used for tax purpose until modern time

Parties to a Trust: Settlor

- Person who contributes or settles property to the Trust (typically $5 bill or silver wafer)
- Must own that property
- Must have mental capacity
- Must be a voluntary contribution

Parties to a Trust: Trustee

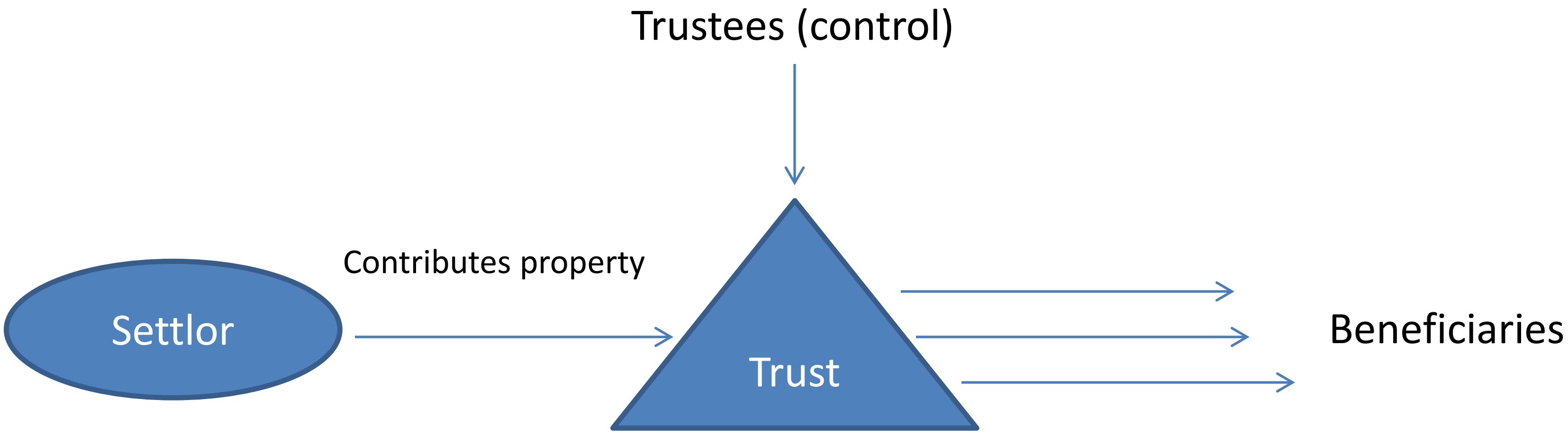
- Of majority and competent
- Person who holds and administers property
- Fiduciary duty to the beneficiaries
- Authority to administer and exercise discretion

Parties to a Trust: Beneficiaries

- Person entitled to use or enjoy the property
- Discretionary vs fixed interest
- Income vs capital interest
- Must be a legal person or entity and can include:
  - Individuals, group of persons, identifiable class of persons
  - Corporation
  - Another Trust

To start a Trust

- There must be three certainties:
  - Certainty of intention
  - Certainty of property
  - Certainty of objects
    - Persons or purpose to be served or benefited must be known with sufficient certainty
    - Persons must be named or identified as an identifiable class (can't say friends or family as they are too vague)
    - Purpose must be stated with certainty


Trustees (control)
Contributes property
Settlor
Trust
Beneficiaries

Two types of Trusts we will discuss

- Personal Trust (sometimes we call it Family Trust) – Inter vivos (Not testamentary)
- Bare Trust

Family Trust – From tax perspective

- You can set up a Trust to split income between many beneficiaries
- Can make the trust distribute fixed amount to each beneficiaries each year or can make it discretionary
  - Discretionary is always advisable
- Can include clause to add or remove beneficiaries even after Trust is created

Family Trust – From tax perspective

- Trust has lifespan of 21 years (there is deemed disposition at every 21 years of all Family Trust asset)
- Asset of the Trust can be distributed to beneficiaries at cost
- Year end is always Dec 31 for Inter Vivos
- Income distributed to the beneficiaries retain same type of income characteristics
- Losses CANNOT be allocated to the beneficiaries

Common scenario

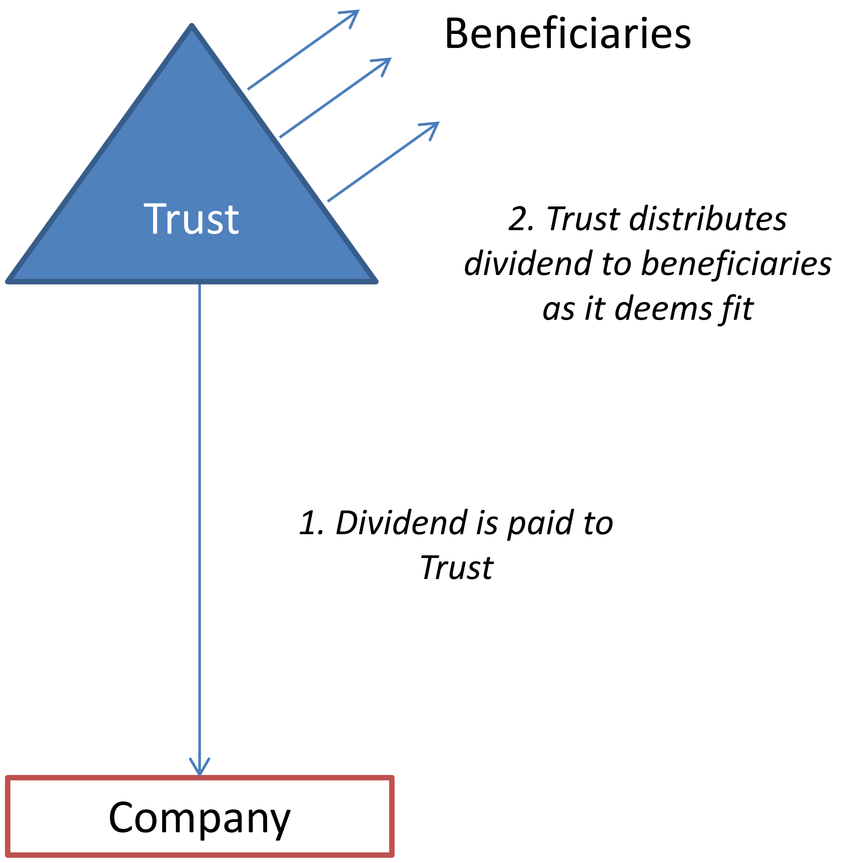
- Trust should not retain any income by the year end. Otherwise, it will pay flat tax rate equal to the highest personal tax rate. Rather, should distribute all income to beneficiaries (or make it payable)

- A settlor shouldn't simply transfer his/her shares of a company (which has value) to the Trust. Any transfer from the settlor to the Trust is done at fair market value and no rollover exists

    - Rather, consider s86 beforehand to strip value out of company

- No investment income should be distributed to beneficiaries under 18. Otherwise, attribution rule or kiddie tax rule will apply

- Watch out for related/associated/connected test



Family Trust – From tax perspective

- Whatever settlor contribute should not be used to make investment since if so, the income from investment will be attributed back to the settlor
- Therefore, if settlor contributes $5 bill, you staple that $5 bill to the Trust agreement and not use that $5 for anything
- Once the Trust is settled, someone should lend money to the Trust (and charge interest). The Trust can then use this money to make investments

Family Trust – From tax perspective

- Watch out for reversionary Trust rule. Applies when:
  - Property can revert to the settlor
  - Settlor has control over the ultimate passage of property
  - Settlor can veto the disposition of the Trust property or requires his/her consent
- If caught, all income of Trust reverts back to the Settlor

Family Trust – From tax perspective

- How to get around it?
  - Property can revert to the settlor
    - Indicate on the Trust agreement that the Trust is irrevocable (ie. can't be cancelled). Also, settlor should not be a beneficiary
  - Settlor has control over the ultimate passage of property
    - Settlor should not be one of the Trustees
  - Settlor can veto the disposition of the Trust property or requires his/her consent
    - Settlor should not be one of the Trustees and there shouldn't be any clause in the agreement stating that Settlor can veto

Family Trust – From tax perspective

- Typically, when we set up Trust for tax purposes, settlor's sole responsibility is to put down $5. So get a good friend or relative
- Trustees should be ideally 3 people with one being not related (like a friend or lawyer)
- Trustee can be a beneficiary. However, if there is only one Trustee and one beneficiary and they are the same person, there might be problem

Family Trust – From tax perspective

- Need to file Trust return (T3) by March 31. Will issue T3 slip to beneficiaries
- No balance sheet is reported

Association Test

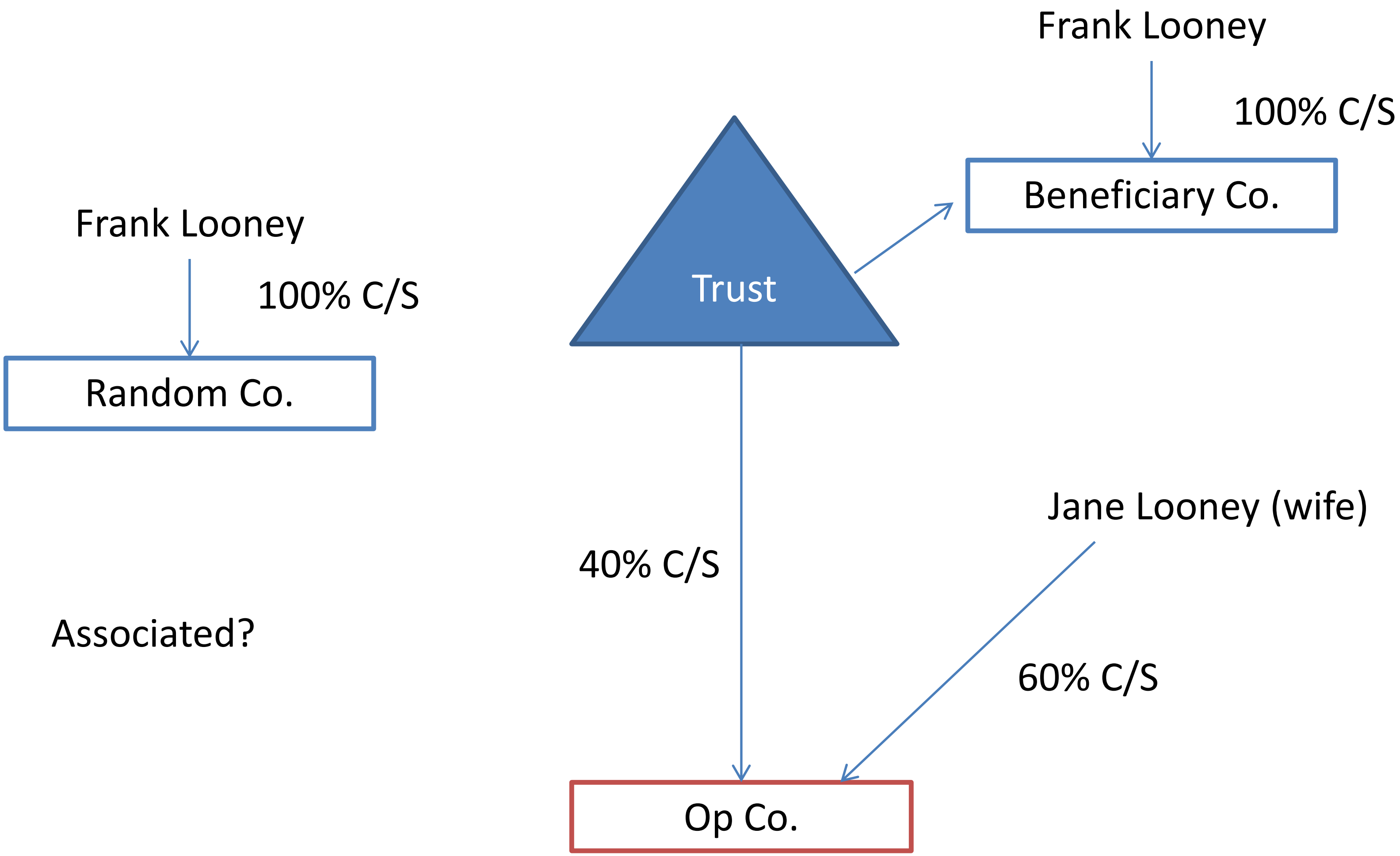
- Association test for sharing small business deduction
  - Each beneficiary is deemed to own all shares of a company that the Trust owns
  - So if a Trust has 5 beneficiaries and the Trust owns 60% of CCPC Inc., then each beneficiary is deemed to own 60% of CCPC Inc. for the purpose of association test

Connected Test

- Connected Test for Part IV test
  - If a corporation (Invest Co) is a beneficiary of a Trust, then that corporation is connected with another company (Op Co) owned by the Trust if:
    - Invest Co owns more than 10% in votes and values of Op Co; **Or**
    - Entity not dealing at arm’s length with Invest Co controls Op Co

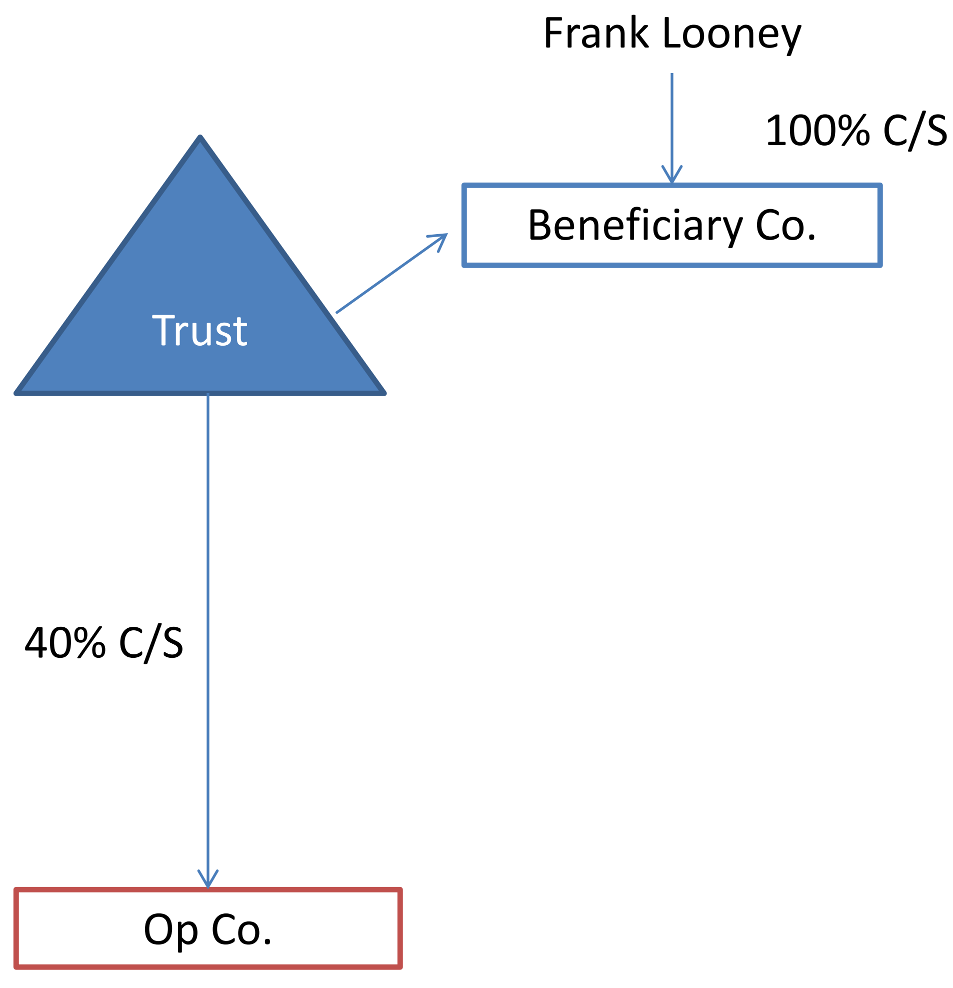
    (Beneficiary is deemed not to be dealing at arm’s length with the Trust)

Association rule



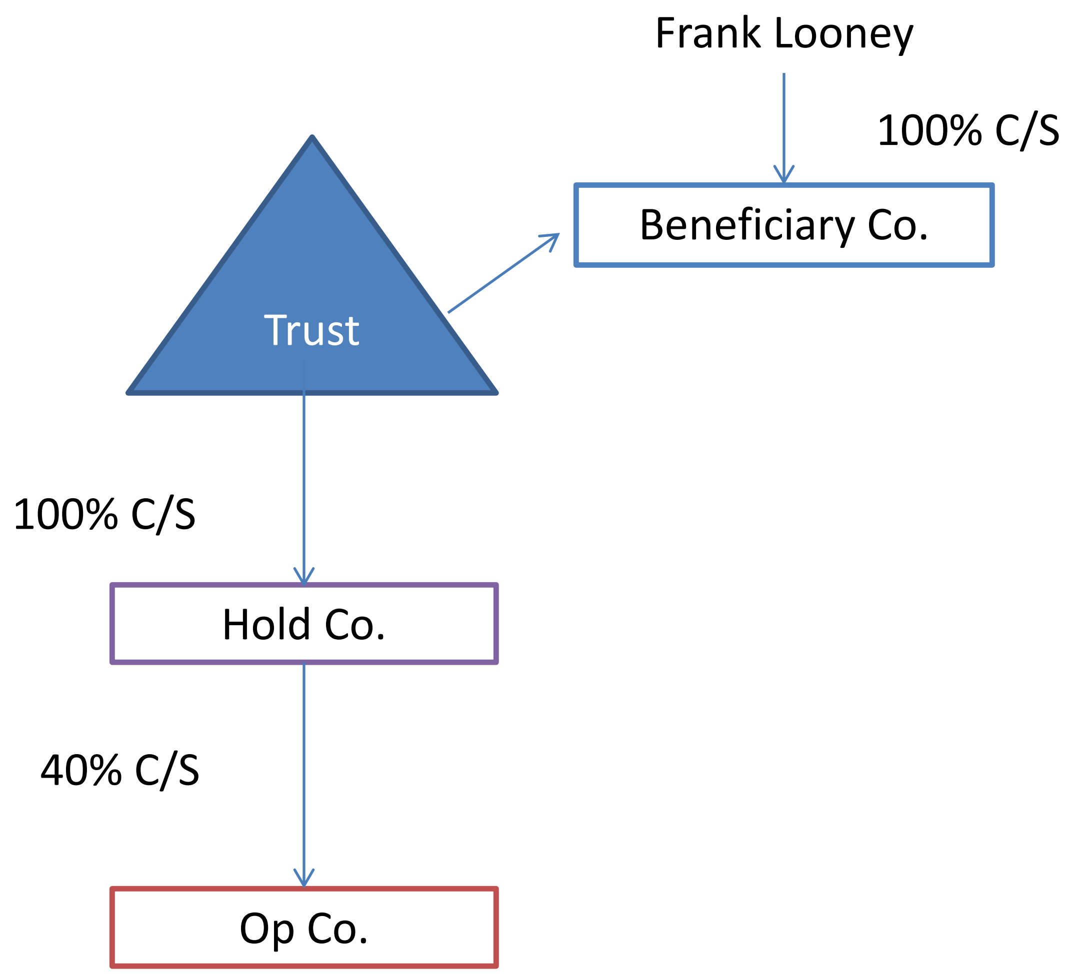
Associated?

Connected rule



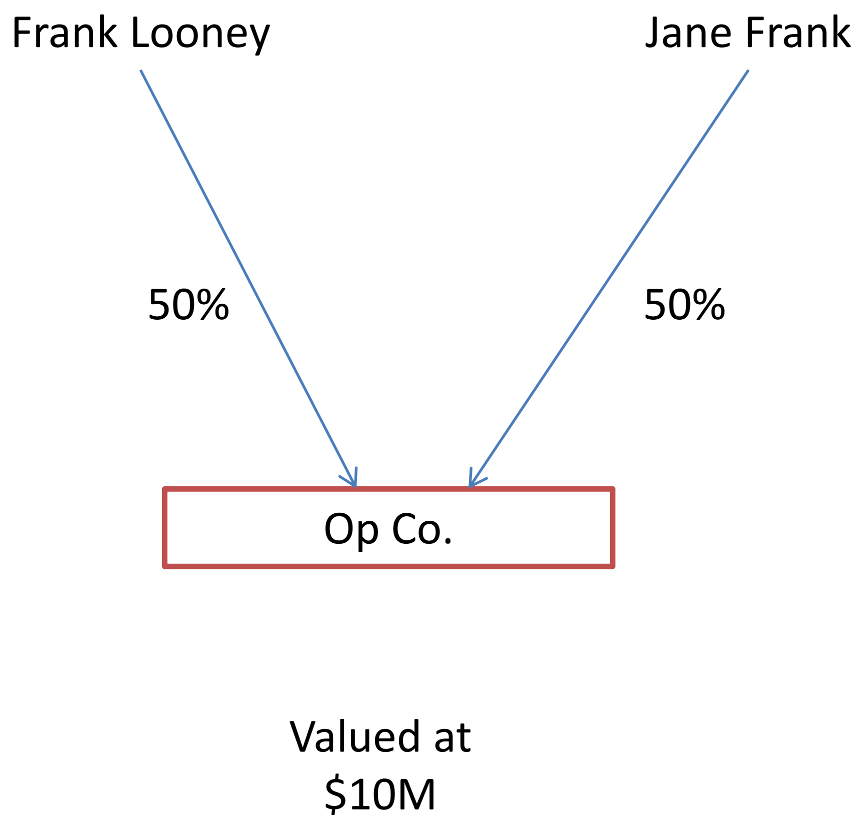
Connected? Can dividend flow from Op Co to Beneficiary Co without Part IV tax?

Connected rule

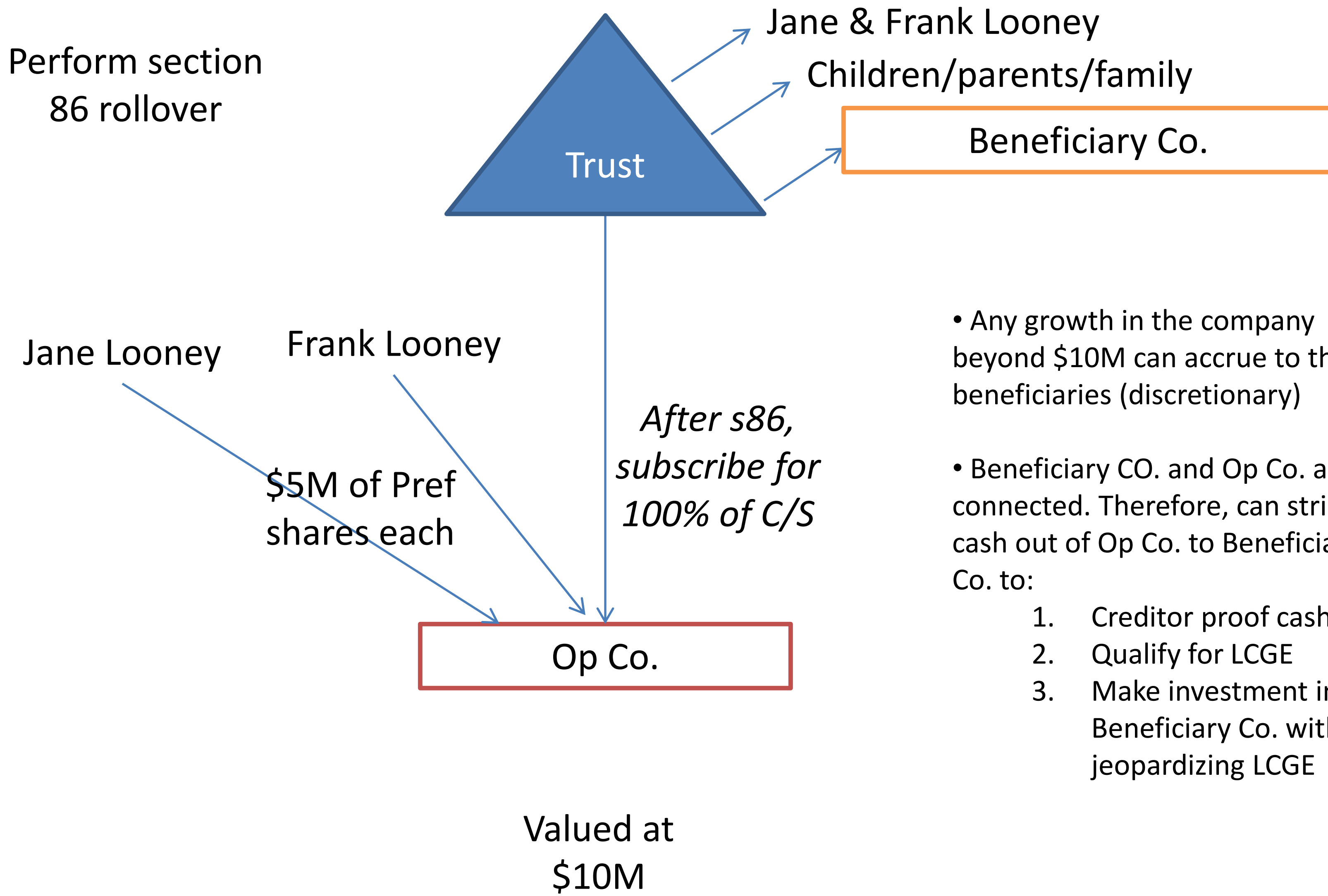


Connected? Can dividend flow from Op Co to Beneficiary Co without Part IV tax?

Typical reorg (if have control of Op Co)



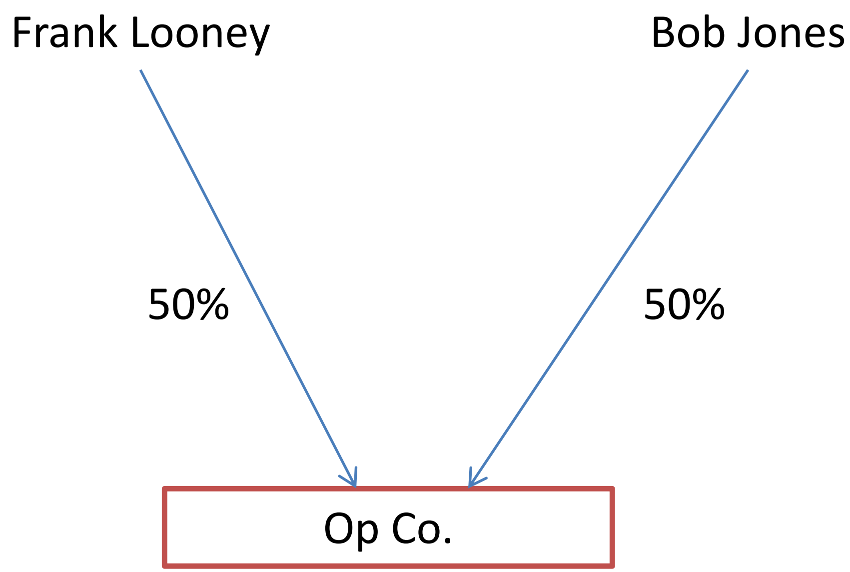
Typical reorg (if have control of Op Co)



- Any growth in the company beyond $10M can accrue to the beneficiaries (discretionary)

- Beneficiary CO. and Op Co. are connected. Therefore, can strip cash out of Op Co. to Beneficiary Co. to:
    1. Creditor proof cash
    2. Qualify for LCGE
    3. Make investment in Beneficiary Co. without jeopardizing LCGE

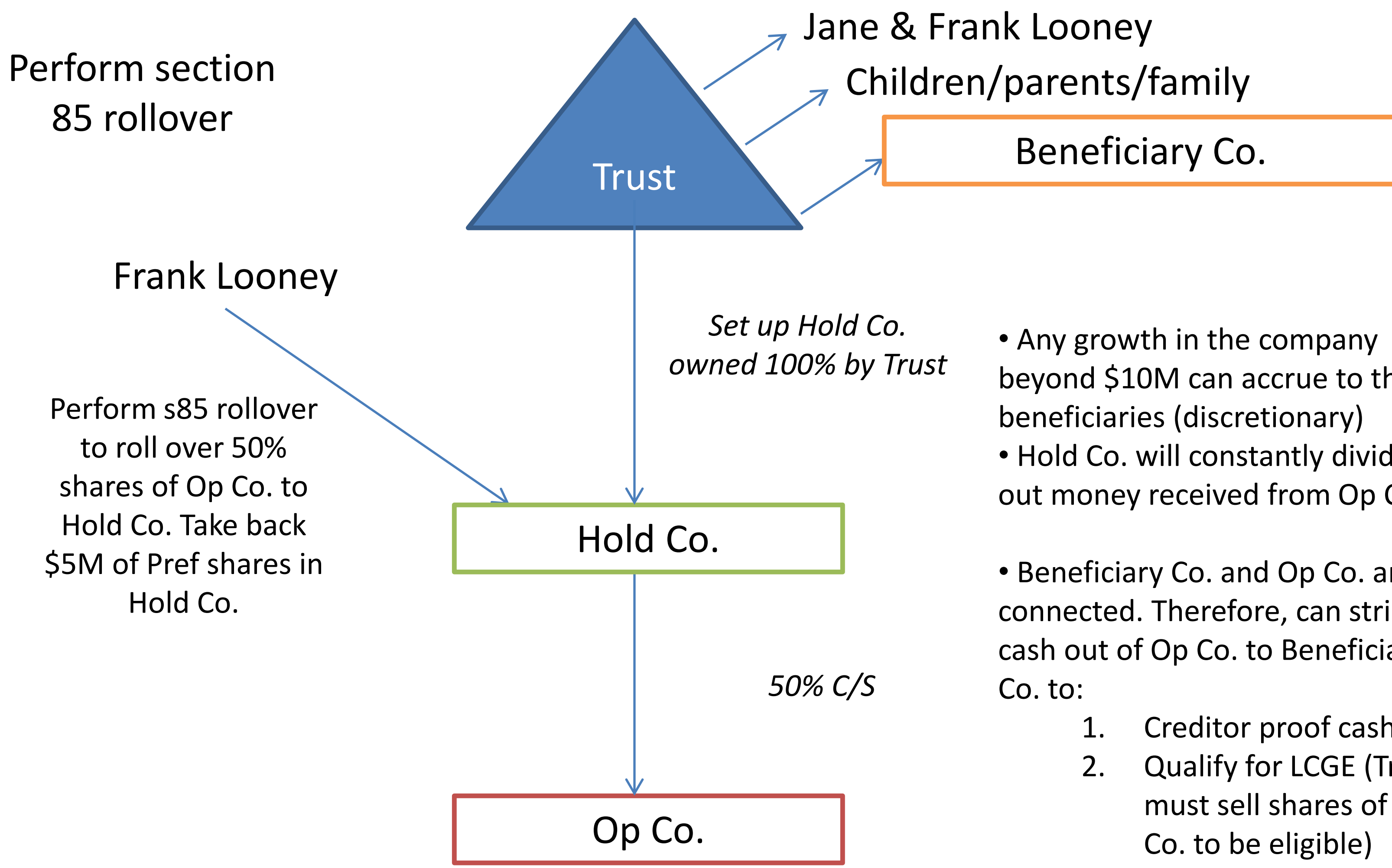
Typical reorg (if don't have control of Op Co)



Frank and Bob are not related

Valued at $10M

Typical reorg (if have control of Op Co)



- Any growth in the company beyond $10M can accrue to the beneficiaries (discretionary)
- Hold Co. will constantly dividend out money received from Op Co.

- Beneficiary Co. and Op Co. are connected. Therefore, can strip cash out of Op Co. to Beneficiary Co. to:
    1. Creditor proof cash
    2. Qualify for LCGE (Trust must sell shares of Hold Co. to be eligible)
    3. Make investment in Beneficiary Co. without jeopardizing LCGE

Typical reorg (if have control of Op Co)