

Trusts - Hull on Estates Podcast #71

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Suzana Popovic-Montag: Hi and welcome to Hull on Estates. You're listening to Episode 71 of our podcast on Tuesday, August 7th, 2007.

Welcome to Hull on Estates, a series of podcasts for the Canadian legal community dealing with issues and insights surrounding estate planning in Canada. Hosted by the lawyers of Hull & Hull, the podcast will touch on some key considerations when planning estates and Wills. Now, here are today's hosts.

Ian Hull: Hi Suzana.

Suzana Popovic-Montag: Hi there Ian. How are you?

Ian Hull: I'm just terrific thanks.

Suzana Popovic-Montag: That's good.

Ian Hull: I took a little time off last week. And during my down time when I was relaxing, I was listening to some of the old podcasts and listening to some of our previous attempts at trying to pass on the word. As I noted, and historically, what we're trying to do in these podcasts is talk about real life examples of things that we are gonna, sort of the topic we're dealing with. And today's topic, I thought we could deal with, is just begin to consider some of the details, in some more detail the use of trusts when doing estate planning. And I...it came to mind and what sort of triggered me to get into this topic was a recent example of a situation where a family had put their family cottage into a cottage trust. And sort of what unfolded, just the story is. And it's a case that's reported in the Ontario Courts, is that the father who set up the trust when the children were young for a lot of the reasons that we're going to talk about over the next couple of podcasts: protecting creditors and things like that. He set it up and then lo and behold, by the time...they lived, and enjoyed it when they were young, and then the children were hitting their twenties and started to want their own cottages and want their own different places. And what happened was fairly aggressive litigation ended up ensuing. And what was a happy place turned into a happy place for lawyers as opposed to the family.

Suzana Popovic-Montag: I'm actually quite surprised, Ian, these days how many of these, you know, we call them cottage fights, we actually see. It's quite remarkable that that's sort of become such a flashpoint. I guess, as people become more affluent, they have, you know, a second property or cottage property. It just opens up these avenues for litigation.

Ian Hull: Well it does. And so let's, you know, why don't we go back to, after sort of considering that real world example. Let's go back to sort of first principles on trusts because a lot of clients will come to see us and they're anxious to set up a trust. And

what I thought we might do is, let's sort of start at the beginning here. And what is a trust all about?

Suzana Popovic-Montag: Well, Ian, a trust is created when you have a transfer of property from one person to another, who's usually called a trustee. And there can be more than one trustee, who will hold that property then in trust for the ultimate beneficiaries.

Ian Hull: And so that ultimate beneficiary is the one who will enjoy the asset at some point in time or during the course of the trust.

Suzana Popovic-Montag: That's right. And that person is known to have basically the beneficial interest in whatever the asset is that's actually settled in the trust.

Ian Hull: So as I understand, of course there are various trusts, there are different types of trusts that are created. What are some examples?

Suzana Popovic-Montag: Well, Ian, we can have a trust that can limit what kind of interest the beneficiary can have. And normally what you have is you have a capital and an income interest that arises in a trust. And you might provide that the beneficiary is only entitled to the income that is generated by the assets in trust. Or you might take it a step further and say they also have a right to encroach on capital as well.

Ian Hull: So the more the flexibility that's created into this, and now when I say flexibility I mean the trustees, what we call sort of the presidents of this little company, the people who are in charge. The more flexibility that the trust document itself gives them, the more opportunities for creative use of these trusts there are. And the balancing act, of course, is that trusts give us protections, fundamental protections that we're gonna talk about. But at the same time, we can't go outside of the parameters of that or we'll lose those protections. And, for example, we'll lose some of the tax advantages, we'll lose some of the creditor protection advantages that they can have. What is...let's just start with the tax side. Without getting overly technical, what are the sort of significant consequences from a tax standpoint with a trust?

Suzana Popovic-Montag: Well, generally speaking Ian, when you create a trust in the right circumstances, you can actually reduce the taxes that would be paid on the income that's earned in the trust in a particular year.

Ian Hull: So the creation of the trust itself...when we establish a trust and let's go back to that cottage example. We have a family, a young family starting out. And the father decides that he's a stay-at-home Dad and the Mom is working hard and making lots of money. And they decide that they want to have a secondary residence. The principal residence is the house in the city and they decide they want a recreational property. So they establish this trust. And the mother is a, let's say a financial advisor, someone who might be professionally, personally liable for claims and so on. So they put the trust...they think well, gee, let's buy this cottage. And we want it, of course, 'cause the

kids are young and cute and want to swim and so on. We want to put this cottage into a trust. The first significant tax consequence that we want to keep in mind is, of course, that there's a price, the cost of that trust, the cottage that goes into the trust, is the starting point of the value that Revenue Canada starts to use as a benchmark. And what some people do, though is, is that they'll buy the cottage. And then five years later, decide they want to create this trust for a bunch of good reasons. And we can get into that for tax planning reasons and so on. But we can't forget the sort of first principle tax consequence of creating a trust is that when you put the asset in, there's a deemed disposition.

So an example is this, is that five years later, you've bought this cottage in Muskoka. And five years later, you realize you want to put it in a trust but then you find out that there's going to be a deemed disposition. They're going to take this asset and whatever you paid, say you paid \$500,000 for the cottage five years ago and now the cottage is worth \$750,000. The one consequence even before anything else happens is the tax person is coming to collect some tax. So it'll be a capital gains tax that's gonna get created because there's the disposition of the trust - the dock, the cottage from your name personally into the trust itself. So that's just something to keep in mind. And I say that example because you wanna plan ahead, you wanna think ahead. Like anything, when you want protection from these sort of useful planning tools, you have to stop, take a deep breath and think long term, short term, and even medium term as to what you want to accomplish. And if you don't, you might get stuck with a tax hit that makes this, creating this trust impossible. Because for my example, maybe you can't pay the income tax that's payable on establishing the trust because you hadn't thought ahead.

Suzana Popovic-Montag: That's a good point, Ian, and I think that that's something that, you know, you get so embroiled in the planning and, you know, the benefits of the trust that you might miss something as basic as the fact that there is this deemed disposition the moment you settle property in trust.

Ian Hull: So the tax consequences are one thing and we're not going to get overly intense on the issue, but that's something just to keep in mind. But I think the important rule, as you just said is, is to sit back, take a deep breath and say, what do I want to do, what do I want to accomplish by this trust? And then the second thing, and we've talked about this in other podcasts, is that you don't want to create an estate plan that is tax focused exclusively. You need to...I tell my clients consider all of the options, not just the tax consequences of every option. And the other part, the other sort of other half of creating a trust is, is that there's a certain amount of control that you lose. And that was what that whole case was about when we started at the beginning was is that Mom and Dad thought it was their cottage. They put it into a trust for what was, at that time, creditor protection. And we can talk about creditor protection and what that means. But basically, it makes it tough for creditors to come after the asset if it's in a trust. But they did that and they didn't think through. Like the tax example, they didn't think through the consequences of creating the trust and the loss of control from their standpoint. Because all of a sudden, what happened in that case was it wasn't their cottage anymore. It was actually the beneficiary's cottage and in that case, it was the children. So the

children had a tremendous vote on what would happen to this property. And when they got older, the parents got older and the kids got older, and when they wanted to sell the cottage, the kids said I don't...one kid said I don't want to sell. The other kid said I do want to sell it but you've got to pay this price for it. And it created a whole bunch of litigation. And so the loss of control was something that when they set it up, when they were cute at two and three, they never thought through. And they didn't...well maybe they did think through...but they didn't think it through well enough because obviously litigation ensued.

So it seems to me, anyway, that, you know, like all estate planning tools, there is always sort of this fancy, use a fancy term like create a trust and people go to it and they gravitate to the idea. But they sometimes don't think through the whole consequences of it. And I'm not saying we shouldn't create trusts, we shouldn't use them. They're perfect planning tools in the right situation. And I don't want to be for a minute being nay saying about a trust. I'm just trying to make it clear that I think that, you know, my clients sometimes don't think through all of the consequences.

Suzana Popovic-Montag: And it's just like a lot of the probate tax planning that we see and we want to be sure that we're doing it for the right reasons. So that we don't become a product of like, the tail wagging the dog essentially.

Ian Hull: Absolutely. So the last thought I had on this was in this sort of introductory comments on the trusts and using trusts in estate planning. Another benefit of creating a trust is, is that...and this is a positive note as opposed to the negative, the tax and the loss of control which I always like to start with the negatives and then see if the positive balance out. And one of the things a trust does is it creates a trust that you can leave an asset in trust for beneficiaries that really protects that inheritance from the beneficiaries' creditors and it is essentially a nice legacy that you're leaving. And you've got some mechanism to preserve that legacy. And so there are lots of good reasons to create the trust. And as I say, I don't want to focus exclusively on a cottage. But a cottage is an easy example where, if you really do think that you want that cottage to stay in the family for as long as many generations as you possibly can, then it does create an important mechanism. And using the cottage example, though, you wanna make sure that you've also got it well funded so that there are expenses that are being covered or some mechanism being covered. Because if that starts to dry up, then you can't maintain the trust and those sorts of things. But that's the other, sort of my third thought, in terms of the use of trusts generally.

Suzana Popovic-Montag: And maybe just to add a little bit to that Ian. Even if you don't have creditors necessarily, you know, sort of looming around the assets. A trust is also a very good means by which to protect minor beneficiaries, individuals who are less than the age of eighteen or nineteen whatever it might be in whatever jurisdiction you live in. And it protects those individuals from becoming, you know, suddenly very affluent or from not managing the assets properly until they become responsible and good citizens who are in a position to accept large bequests or important assets in their own names.

Ian Hull: Now that's a great point. Alright, well I think we've at least scratched the surface on the concept of trusts and estate planning. We have lots more we can consider and talk about. And we'll save that for another podcast. Thanks very much, Suzana.

Suzana Popovic-Montag: Thanks to you, Ian.

This has been Hull on Estates with the lawyers of Hull & Hull. The podcast you have been listening to has been provided as an information service. It is a summary of current legal issues in estates and estate planning. It is not legal advice and you are reminded to always talk with a legal professional regarding your specific circumstances.

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