

Tax Planning Your Will Part 2

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In Part 1 of this article that was in our Summer Newsletter, we discussed the use of multiple testamentary trusts in a Will for tax purposes and showed – through the use of an admittedly extreme example – the magnitude of tax savings that could be achieved through the use of such trusts. We suggested that instead of paying inheritances outright to spouses and/or issue, the use of such trusts, structured in a manner that is almost akin to holding the assets outright, can be a tax-effective form of estate planning. Part 2 of the article will explain the specifics of how these tax-planned trusts are drafted.

In order for a spousal trust to receive the rollover benefits under the Income Tax Act, all income generated in each year must be paid to the surviving spouse, and while there is no requirement to pay all of the underlying capital to the spouse, nobody other than the spouse can have a right to it while her or she is alive. Spousal trusts are most commonly used to protect assets for future generations and to maintain some control over the use of these assets during the surviving spouse's lifetime. In these circumstances, one or more independent trustees are appointed (which may be in addition to the spouse acting as a trustee) to provide this protection or control. However, in the case of a purely tax-planned trust, the spouse would be appointed as the sole trustee and would have the unfettered discretion to encroach on the entire capital of the spousal trust if he or she so desires. In this regard, the use of the tax-planned spousal trust is akin to paying the assets outright to the surviving spouse (as she has complete control of the assets), but its tax-planned nature has the additional benefit of establishing a testamentary trust that may enjoy annual tax savings. Upon the surviving spouse's death, the assets of the spousal trust would be divided among contingent beneficiaries in accordance with the testator's wishes contained in the Will. If the proposed multiple testamentary trust approach is utilized, the assets would be divided among the testator's children and/ or grandchildren and added to the capital of their respective trusts if already established, or, where the testator chose to only use a spousal trust upon his death, separate testamentary trusts or a single discretionary family testamentary trust could be established upon the surviving spouse's death.

Like spousal trusts, tax-planned testamentary trusts established for the benefit of a single child or grandchild can similarly be drafted so that the assets are held in trust for the lifetime of the child or grandchild as opposed to having the assets distributed outright to such child or grandchild or at a certain age. If the testator's intention was to distribute the

assets outright to the child or grandchild, the child or grandchild could be named the sole trustee of his or her own trust. Not only would this achieve maximum flexibility on the payment of income or capital to the child or grandchild (since he or she could encroach on the whole of the capital of the trust), but it would allow the child or grandchild to also take advantage of the trust's graduated rates. Alternatively, if the intention of the testator was to hold the assets in trust for such child or grandchild until attaining a certain age, the testator could appoint someone other than, or in addition to, the child or grandchild to act as trustee of the trust with discretionary income and capital encroachment powers. Upon the child or grandchild attaining a specified age, the child or grandchild could become the sole trustee of his or her own trust (at which point, he or she could encroach on the whole of the capital of the trust if he or she so desired). Like the spouse being the sole trustee of the spousal trust, having the child or grandchild act as the sole trustee of his or her trust (whether initially or upon attaining a certain age) allows the child or grandchild to enjoy the tax savings of a testamentary trust while providing him or her with the same flexibility to do as he or she pleases with the assets as if they had been paid outright to him or her.

Finally, as its name suggests, the single discretionary family testamentary trust discussed above established for the benefit of all children and grandchildren (and perhaps the spouse) as discretionary beneficiaries would provide the trustees of the trust with the discretion to determine who will receive income or capital from the trust, providing that distributions of income or capital can be made at any time to one or more family members to the exclusion of any or all of the others. Different beneficiaries can receive income and capital payments at various times. This structure can prevent an irresponsible child from misusing the funds, and may afford creditor protection for those beneficiaries that may require it. The choice of trustees for this type of trust can be a difficult one, given the multitude of beneficiaries and potential conflicts of interest. Therefore, the choice of trustees will depend on the testator's circumstances. Conversely, where multiple discretionary family testamentary trusts are being used for the benefit of each child and his or her issue, the choice of trustee becomes easier – typically the child of the testator is the sole trustee of his or her discretionary family trust.

Part 1 of the article illustrated the substantial annual tax savings that can be enjoyed through the use of multiple testamentary trusts in a Will. When these savings are combined with the flexibility afforded by these trusts (as described in Part 2), the result is a relatively simple and highly effective way of tax planning your Will to benefit your loved ones. It's worth a talk - "trust" us!