FAMILY TRUSTS - DOWN BUT NOT OUT

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Recent changes to the Income Tax Act have caused many people to conclude that family trusts are no longer useful planning vehicles. Don't be quick to jump to this conclusion. There are still many reasons to use family trusts.

In the past, the existence of a family trust as a shareholder of a corporation meant that dividends could be paid to the family trust and taxed in the hands of minor children. If the child had no other income, the child could receive up to $24,000 per annum without tax. Unfortunately for years after 1999, there will no longer be any benefit to having dividends from private corporations tax in the hands of minor children. With the introduction of the income splitting tax or "Kiddie Tax" as it has come to be called, these dividends will be taxed at the top marginal rate except in certain specific situations.

The loss of the tax advantage with respect to dividends does not mean that there are no benefits to family trusts. Consider the following advantages which still exist:

- **Estate Freeze** - having a family trust as a shareholder after freezing an owner-manager's common shares will reduce taxes payable on the deemed disposition which occurs on the death of the owner-manager.
- **Sale of a Business** - where a private business is sold or goes public, it may be possible to multiply the capital gains exemption of up $500,000 of capital gain on shares of a qualified small business by the use of a family trust. Capital gains realized by a family trust can be allocated to the beneficiaries.
- **Dividends to Adult Children** - a family trust can still be used for dividends where the children are over 18 which could be of use where there are children attending university.
- **Confidentiality** - aside from the requirement of filing an annual trust return with Canada Customs and Revenue Agency, there are no requirements to disclose the creation or operations of a family trust unlike that of a corporation where shareholders and shareholdings are a matter of public record.
- **Creditor Proofing** - property which is beneficially owned by a family trust does not form part of the estate of the creator of the trust. No creditor claiming against the person who created the trust or any discretionary beneficiaries can have a direct claim against the trust property. In certain situations a family trust can be used as an effective method of providing support for children where there is a matrimonial breakdown.
- **Separation of Beneficial and Legal Ownership** - a trust allows one group of persons to control the property in the trust and the other group of persons to own the property and receive any benefits that accrue to the property. This is particularly useful where parents wish to retain control of a small business or other asset yet pass any growth on to their children.
- **Lack of Structure** - a trust is a very flexible vehicle because the trustees can be given unlimited discretion with respect to the payment of income and capital out of the trust. There is very little legislation which affects family trusts.
- **Avoidance of Problems with Wills** - where property has been transferred to a trust, it will not form part of the estate of the person who created the trust. This avoids the public disclosure which is part of the probate procedure. In addition, possible challenges to the will based on lack of capacity or undue influence may be minimized. The cost and delay of estate administration including probate fees will be avoided.
- **Insurance** - more complex planning opportunities exist with respect to the use of insurance and family trusts. This can result in an avoidance of the 21 year deemed disposition rule. If the insurance policy is an exempt policy, there can be a defferal

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and the potential for complete avoidance of attribution on the accumulating income. The attribution rules are designed to prevent the spreading or splitting of income among related parties to reduce the overall taxation on the income.

In summary, there are many reasons to continue to consider the use of a family trust. Any of the above circumstances may produce benefits in your particular situation. Setting up a family trust however, should not be undertaken without consulting your professional advisors with respect to both tax and non-tax implications. ▲

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