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Trust Basics

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Many individuals include trusts as key components of a comprehensive wealth and estate plan. You may have friends, relatives or business associates who have their own family trust. Yet there is often much confusion about what a trust is, when to consider using a trust and how to go about finding a trustee.

What is a Trust?

In the simplest terms, a trust is created when property is transferred (settled) from one person (the settlor) to another person (the trustee); the trustee holds legal title to all trust property for the benefit of certain persons (the beneficiaries). The comments that follow focus on trusts:

- that are set out in writing in a document called a trust deed; and,
- that are settled during the settlor's life time (inter vivos trusts) rather than on death in the settlor's will (testamentary trusts).

A trust, unlike a corporation, is not a legal entity; rather a trust is a relationship that is created among the settlor, trustee and beneficiaries under the terms of the trust deed. Trust deeds are tailored to each situation which provides an opportunity to achieve a wide range of personal, income tax and/or business objectives in a single document.

When to Consider Using a Trust

While the potential uses of trusts are virtually unlimited, there are common scenarios to which trusts are well suited.

Private Operating Company Shares

If you are a shareholder in a private operating company, chances are that you hope to sell your shares at a substantial gain at some future time. Significant income tax advantages and incentives exist for private operating companies under the Income Tax Act. Many of these advantages can be most effectively obtained through share ownership structures involving a family trust including: capital gains splitting, multiplication of the \$750,000 capital gains exemption and income splitting.

For example, if a trust is settled at the time an operating company (Opco) is incorporated, the trust could acquire shares of Opco for a nominal amount. If the beneficiaries are mom, dad and two children, the shares could increase in value by \$3 million without attracting income tax. If the same shares had been held by dad alone, only \$750,000 of value would be sheltered. A similar result can be achieved if a trust is settled after Opco has been incorporated and the shares have already increased in value through the mechanism of what is commonly referred to as an 'estate freeze.'

From a pure business perspective, the trust structure is advantageous when dealing with a potential purchaser. The purchaser only has to negotiate with the trustee as legal titleholder to the shares, rather than with multiple shareholders. This can be critical if shareholders are minors (in which case the public trustee would otherwise have to be involved to represent their shareholdings in a potential sale and with respect to the sale proceeds). There may also be other family dynamics at work that could interfere with the negotiation and sale process when individuals hold shares directly.

Private Foundations

Another situation where trusts are used is in establishing a private foundation. This type of philanthropic structure commonly arises when Opco shares are sold or a family otherwise comes into a significant amount of wealth. Entrepreneurs often enjoy the flexibility and control offered by a private foundation, as compared with making a donation to a public or community foundation. There are many considerations when deciding whether a private foundation is the right approach, including:

- the ability to set investment policies;
- a desire to be able to make grants without being constrained by a

- set grant cycle or narrow grant parameters; and,
- the opportunity to involve and mentor family members in the various business and value-based aspects of philanthropy.

A private foundation can be created by way of a trust or a non-share capital corporation. A private foundation trust offers the most flexibility in tailoring a foundation that is suited to your objectives. A professional advisor with knowledge and expertise in charity law and taxation should be consulted for advice on any form of philanthropic planning to ensure all tax and non-tax objectives are addressed.

High Net Worth

There are many other reasons why high net worth individuals and families incorporate one or more trusts into their overall wealth and estate plan including:

- asset protection;
- family dynamics;
- disabled beneficiaries;
- potential predatory behaviour by third parties vis-à-vis ageing parents or vulnerable children;
- income and capital gains splitting through holding company or other investment structures; and,
- mentoring opportunities.

If you think that a trust may be useful in your own circumstances, it is critical that you obtain advice from professionals who specialize in trusts and tax planning.

Choosing a Trustee

A trustee is bound by the terms of the trust deed, trust legislation and general trust law to act solely for the benefit of the trust beneficiaries. However, it is fundamental to the trust relationship that the trustee has legal title to all trust assets and, therefore, has control over the trust property. As a result, the choice of trustee is a critical step in the planning process.

There are essentially three choices when it comes to a trustee, each with its advantages and disadvantages.

1. Family members or friends:

Pros

- may already be familiar with relevant personal circumstances, needs and objectives vis-à-vis the trust;
- generally act for little or no charge.

Cons

- rarely understand the rights, duties and obligations of a trustee;
- rarely have familiarity with trust law, tax law and other areas of law that can arise;
- can inadvertently jeopardize the trust by taking (or not taking) certain actions;
- can jeopardize harmonious relationships or exacerbate existing tensions;
- exposes family members or friends to potential legal claims;
- the trustee may move to other provinces or countries, triggering potentially disastrous tax consequences;
- lack of privacy; and,
- lack of objectivity.

2. Professionals, such as a lawyers, accountants, financial advisors:

Pros

- may already be familiar with relevant personal circumstances, needs and objectives vis-à-vis the trust;
- may act for a nominal fee as a 'favour;' and,
- generally would be objective and independent.

Cons

- many professionals are not familiar with the intricacies of trust law and tax law, which are highly specialized practice areas;
- many professionals and/or professional firms have a general policy against acting as trustee;
- professionals who are willing to act as trustee will typically charge an annual retainer plus hourly rates for time spent to compensate for the risks associated with being a trustee;
- often do not have 'proper' trust accounting, internal controls, documentation and processes to ensure safety of trust property;
- may be sick or on vacation when critical decisions need to be made or requests for funds are made (can result in signing blank cheques 'just in case');

- other individuals in the firm may have access to private trust documents and banking details; and,
- death or retirement may result in the need to replace the trustee (it is the individual, NOT the firm, who is trustee), which adds to costs and inconvenience.

3. Trust company

Pros

- is qualified and experienced;
- is subject to regulatory review;
- has sophisticated accounting, internal controls, documentation, reporting and processes designed specifically for trusts and to ensure safety of trust property;
- has 'proper' banking relationships;
- is independent and objective;
- is accustomed to working in a team with other professional advisors;
- decisions and distributions can be made - without jeopardizing security of funds - even when the regular contact person is away from the office;
- the company, rather than an individual, is the trustee; death, retirement or re-location of individuals within the trust company will not trigger adverse tax consequences or the need to replace trustees.

Cons

- fees can be a consideration for smaller-value trusts;
- some trust companies have restrictions on the type of assets they will administer or what investment advisors they are willing to engage;
- large trust companies can be slow to make decisions due to bureaucracy; and,
- staff turnover at large trust companies can be frustrating.

In summary, trusts have proven integral components of comprehensive wealth and estate planning. Understanding your options and the right path are certainly recommended, and it's vital to ask the right questions when interviewing potential trustees.



Cidel Trust Company

Cindy Radu is the president of Cidel Trust Company. She is a lawyer and an accountant with experience in all aspects of developing and implementing sophisticated estate plans, often involving trusts. Cindy is responsible for the day-to-day operations of Cidel Trust Company and the implementation of various trust structures.

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