

What is a Trust Fund and How Does it Work?

A trust is a formal agreement with respect to property that can be a useful and powerful estate planning tool. It establishes the rights and obligations among parties; settlors, trustees, and beneficiaries. A settlor is the person transferring assets into the trust. The trustee is the person holding legal title to the trust assets for the benefit of the beneficiary and manages the assets according to the trust document. The beneficiary is the person for whom the trust assets are being held.

Ownership of the trust property must be legally transferred to a trustee. The trustee is required to manage the trust property according to the terms established in the agreement and must use that property solely for the benefit of the named beneficiaries.

Although many wealthy Canadians have used trusts for a variety of reasons, trusts are not simply a tool for the wealthy alone. Whether you need to care for someone who has special needs, or you wish to fund a favourite charity, a trust will allow you to accomplish your objectives.

It can be used to split income among family members, reduce probate and estate costs and protect assets from creditors. A trust can safeguard your assets for future generations. It can assist in ensuring your wishes are carried out and your beneficiaries' needs are met.

There are basically two types of trusts for tax purposes: Inter Vivos Trusts and Testamentary Trusts. An inter vivos trust is created while the settlor is alive and must have a December 31 year-end for tax purposes. A testamentary trust, on the other hand, is a trust created within the will of the settlor and takes effect upon his/her death. These types of trusts can have any year-end, however the year-end cannot fall after the day before the anniversary of the settlor's death.

Let's take a closer look at these two types of trusts.

With an inter vivos trust, the assets or cash are not given directly to a beneficiary. Instead, the settlor will place the assets inside the trust for the beneficiary. The trust document will instruct the trustee as to what the assets are for, how and when they can be distributed and so on. In fact, in order to ensure that the assets are used according to his or her wishes, the settlor can put anything in the trust document that he or she wants. This is often seen as a better alternative than simply handing over the asset to the beneficiary. Why? Because that would enable the beneficiary to use the assets for any purpose he or she desires – not for the reason's the settlor planned for the beneficiary to use them.

When assets are transferred into the trust, the settlor is deemed to have disposed of the assets for fair market value proceeds at that time. If assets that have appreciated in value are transferred, a tax liability will be triggered. For this reason, it is generally best to transfer cash or other assets that will not give rise to a tax bill at the time of transfer to the trust.

How does a testamentary trust differ? A testamentary trust is set up in your will and becomes effective on your death. Instead of leaving your assets directly to your spouse or children, you can leave all or a portion of your assets to a testamentary

trust set up in your will. Your heirs can then be named as the beneficiaries of the trust. Under Canada's tax system, a trust is a separate taxpayer, and testamentary trusts are taxed at the same graduated tax rates as individuals. This means, if you leave income-producing assets to a testamentary trust rather than your heirs directly, the trust can pay tax on any income generated on those assets.

Tax considerations in relation to trusts are important. After all, it's not how much you earn, but how much you keep that matters most.

Before creating a trust you need to carefully consider what you wish to accomplish and understand the income tax and other legal considerations associated with a trust. You will need to make a number of important decisions including; who will act as trustee, what property will you transfer into the trust, who will be the beneficiaries, and how will their needs be met, will the trust come into effect while you are still alive or after your death, will the trust be revocable or irrevocable, how long will the trust operate.

A trust can be simple or complex, but in all cases it is important to obtain professional advice and assistance before proceeding. When you decide that a trust is the right solution for you, your trust representative will work with you to provide the advice and service required to establish and operate the trust.

If you would like to discuss your personal situation and how a formal trust will assist you in meeting your goals and objectives or if you have questions about this article, you can contact an OMISTA financial expert at any of our three branches our Credential Financial Strategies Inc. Representative Ozzie MacKay for more information on any of our investments.