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LIVING TRUSTS

Recent increases in probate taxes have prompted a renewed interest in living trusts. These trusts, which are also known as inter vivos trusts, are created by a living individual and begin operating as soon as the agreement is signed and the trust is funded.

The origin of the idea of a trust goes back many centuries in the history of English common law (certainly prior to probate taxes!) and volumes of legal treatises have been written about trusts. Suffice it to say, however, that a trust is really just a property holding device. An individual known as "the settlor" transfers property to a trustee who holds it for the benefit of named individuals, one of whom could be the settlor.

The income earned on the trust may be paid to one or more persons, who are known as the "income beneficiaries." When the trust terminates, the remaining assets are paid to one or more individuals or institutions, referred to as "remainder beneficiaries." The trustee could be an institution or an individual selected by the settlor, or even the settlor himself or herself. Provisions may also be made for a successor trustee in case the one initially named resigns or becomes incapacitated.

Why Trusts Save Probate Taxes

Because trust assets are not part of a person's estate, they do not pass under the will and thus are not subject to probate. Since provincial probate taxes are assessed only against probate assets held at death, they do not apply to distributions from a trust. In some instances this may save the estate thousands of dollars.

Besides saving probate taxes, a trust also protects privacy because it does not become a public document as a will does. This confidentiality is important when, for example, a person wants to provide for a special friend but knows that family members would be upset if they found out about it. Also, a person may use a trust to assure that the size of distributions from the estate don't become a matter of public record.

Uses of Trusts

A living trust can serve a number of family objectives including:

- Providing for family members, such as a physically or mentally challenged child, who has ongoing financial needs but would be unable to handle money.

- Providing financial security over time to a child who cannot be entrusted with principal because of spendthrift habits.

- Providing for professional management of one's own assets when age and health makes personal management difficult.

Recognizing that circumstances change over time, the creator of a trust can give the trustee discretionary powers regarding the individuals who will benefit from the trust and the amount each will receive. Since a living trust, unlike a will, takes effect during lifetime, the settlor can see first hand the results of his or her efforts. If the trust is revocable, the assets could be returned to the original contributor. If it is irrevocable, the property can never be returned; the settlor technically loses control over the assets.

<u>The Charitable Remainder Trust</u>

One type of living trust is the "charitable remainder" trust. The income beneficiary is the settlor and/or another person, and when the trust terminates (either at the death of the income beneficiaries or after a term of years) the remaining principal is given to charity. Because the trust is irrevocable, the settlor is entitled to a donation receipt for the present value of the remainder that will eventually pass to charity. Thus the person would simultaneously make a charitable gift, keep the income from the contributed asset, and save taxes.

<u>Taxation of Living Trusts</u>

Income generated by property in a revocable trust will be taxed as the income of the person who contributed that property. With some exceptions, such as a living trust set up to pay income to minor children or a spouse, income from an irrevocable trust will not be attributed to the creator of the trust. Except in those instances when income and capital gain are attributed to the creator of the trust, the income and capital gain paid to beneficiaries will be taxed to them; but if the trust retains income and capital gain, not paying them out to beneficiaries, the trust itself will be taxed at the highest marginal rate.

Generally, when appreciated property is transferred to a trust, the settlor will be deemed to have disposed of the property and be taxed on the capital gain. However, in the case of a spousal trust, the realization of gain can be deferred. Also, when appreciated property is transferred to a charitable remainder trust, only a portion of the capital gain will be subject to tax, and the tax credit will always exceed the tax on the gain, resulting in net tax savings.

Living trusts are highly versatile, serve many needs, and often save probate taxes. Before implementing a trust, a lawyer should be consulted to determine what arrangement is appropriate and to draft the trust agreement.