Testamentary Trusts

Presented to:

Nakamun Financial Group

February 1, 2008

Commentary included in this presentation includes excerpts from "**Practitioner's Guide to Trusts, Estates and Trust Returns 2006-2007**" [published by Thomson Canada Limited], co-authored by Larry Frostiak, FCA, CFP, TEP and John E.S. Poyser, LLB, TEP "Reprinted by permission of Thomson Carswell, a division of Thomson Canada Limited."

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Testamentary Trusts

- Arises on and as a consequence of an individual's death
- Common forms include:
  - Trusts established under terms of last Will and Testament
  - Trusts established by judges under dependants' relief legislation
  - Insurance trusts
  - Trusts arising from an estate

i. Testamentary Trusts

Does it qualify?

If so:

- Taxed at graduated rates
- No income attribution
- Multiple testamentary trusts / income splitting

ii. Trusts established under Dependants' Relief Legislation

- Established by court order
- Will be considered testamentary if for relief or support of dependants

iii. Insurance Trusts

- Established in a separate trust declaration or agreement
- Funded from life insurance proceeds
- Separate and apart from the estate of a deceased person
- testamentary

iv. Spousal Trusts

- Inter vivos or testamentary
- Property transferred on a rollover basis
- Settlor and the trust must both be resident in Canada
- Ability to elect out of subsection 73(1) to effect transfer at fair market value

v. Qualified Spousal Trust

- Must be created by the Will
- Spouse entitled to all income of Trust

Qualified Spousal Trust (cont'd)

- Only spouse can have entitlement to Capital during spouse's lifetime
- Assets must vest indefeasibly
- Testator must be a resident of Canada

Qualified Spousal Trust

Advantages

- Complete rollover or tax deferral
- Control over assets / capital
- Progressive tax rates
- Ideal for second marriage concerns

Qualified Spousal Trust

Disadvantages

- Deemed disposition of assets on termination
- Not ideal if trust income exceeds needs of spouse
- Potential for higher rates of tax on future income

vi. “Tainted Spousal Trust”

- Not a “Qualified Spouse Trust”
- Still a Testamentary Trust
- Useful as a tool in Estate Planning

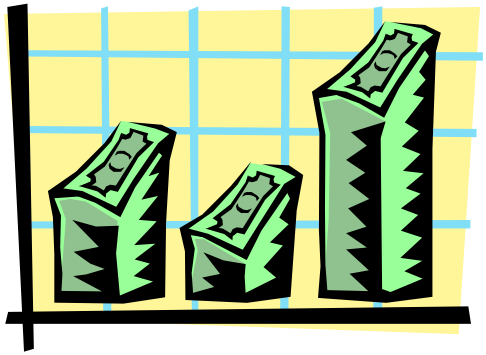
“Tainted Spousal Trust”

- Testamentary Trust – Progressive Tax Rates
- Assets can “roll-out” at cost (deferral)

“Tainted Spousal Trust”

Disadvantages

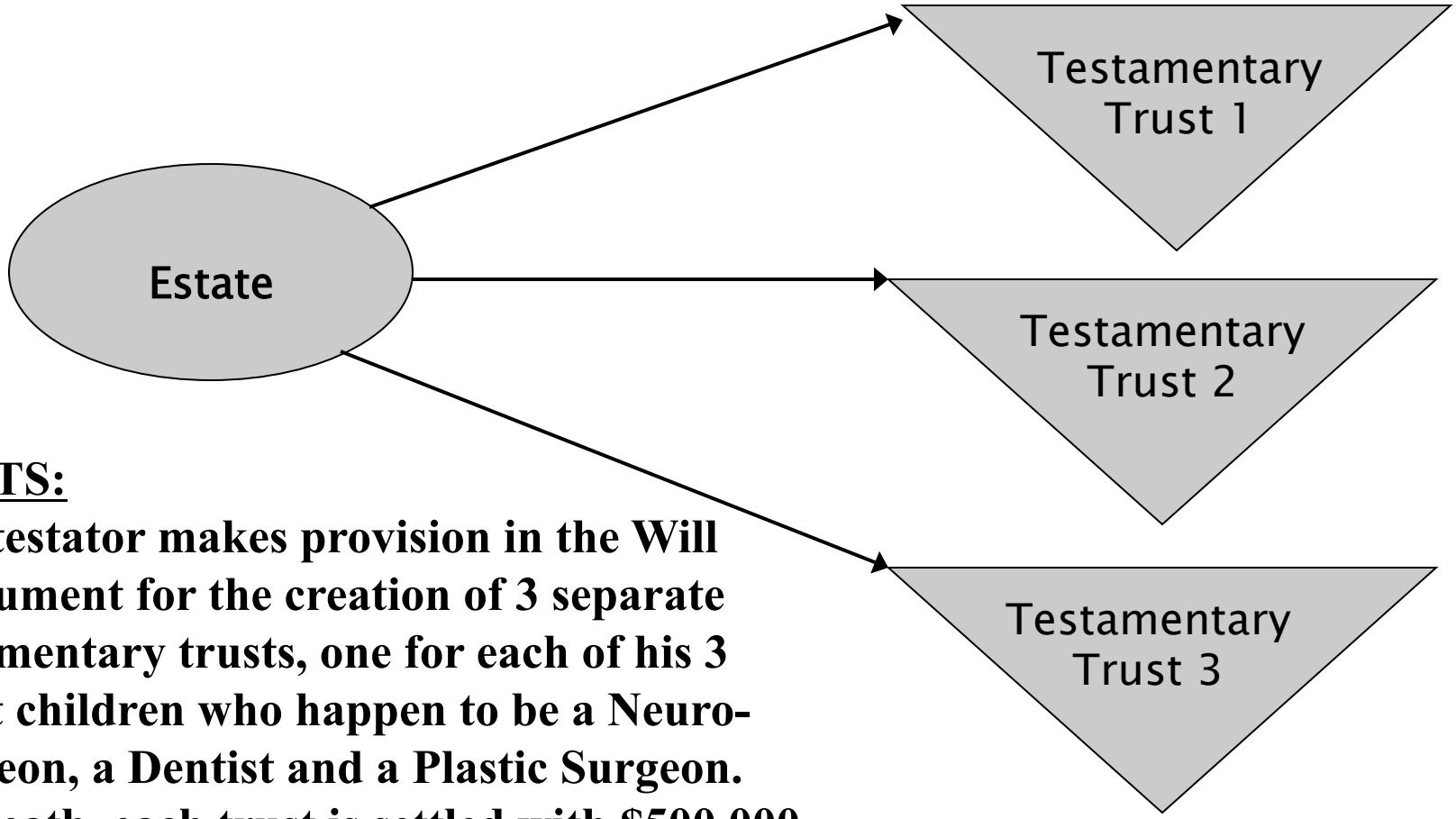
- No tax deferral on assets into trust
- Could be a tax surprise if intended spouse trust becomes “tainted”



Trusts used for Testamentary and Will Planning

- Testamentary trust is an ideal “tool” for estate planning
  - taxed at graduated rates
  - trust can have a year-end other than December 31 which can permit for a considerable degree of tax planning
  - ability to designate income as being taxable to the trust, even though paid to the beneficiaries
  - no income attribution
  - income – splitting / multiple trusts

Trust Used for Testamentary and Will Planning



FACTS:

The testator makes provision in the Will instrument for the creation of 3 separate testamentary trusts, one for each of his 3 adult children who happen to be a Neuro-Surgeon, a Dentist and a Plastic Surgeon. On death, each trust is settled with $500,000.

Trust Used for Testamentary and Will Planning (cont'd)

	NO WILL PLANNING			USING TESTAMENTARY TRUSTS		
	Child 1	Child 2	Child 3	Child 1	Child 2	Child 3
Income from inheritance 500,000 @ 5%	25,000	25,000	25,000	25,000	25,000	25,000
Tax Thereon	(11,600)	(11,600)	(11,600)	(6,725)	(6,725)	(6,725)
	13,400	13,400	13,400	18,275	18,275	18,275

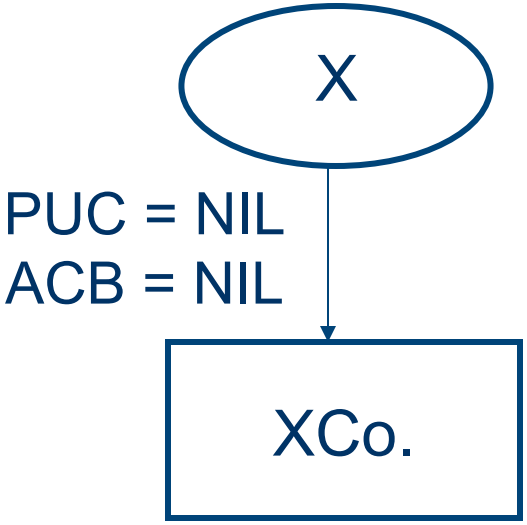
Wealth Preservation

- Trust provides vehicle to transfer “beneficial wealth” to children, grandchildren while maintaining capital management through “prudent trusteeship”.
- Rule against perpetuities abolished in Manitoba, thereby permitting indefinite wealth accumulation

Creditor – Proofing / Confidentiality

- Distinction between beneficial and legal ownership
- Discretionary *Inter vivos* Trust provides only a contingent interest to a beneficiary
- Use of alter ego, joint spousal or joint common-law partner trusts

Double Tax Mitigation Strategies



- holds portfolio investments ($1.0 million) ACB=$500K

ON DEATH

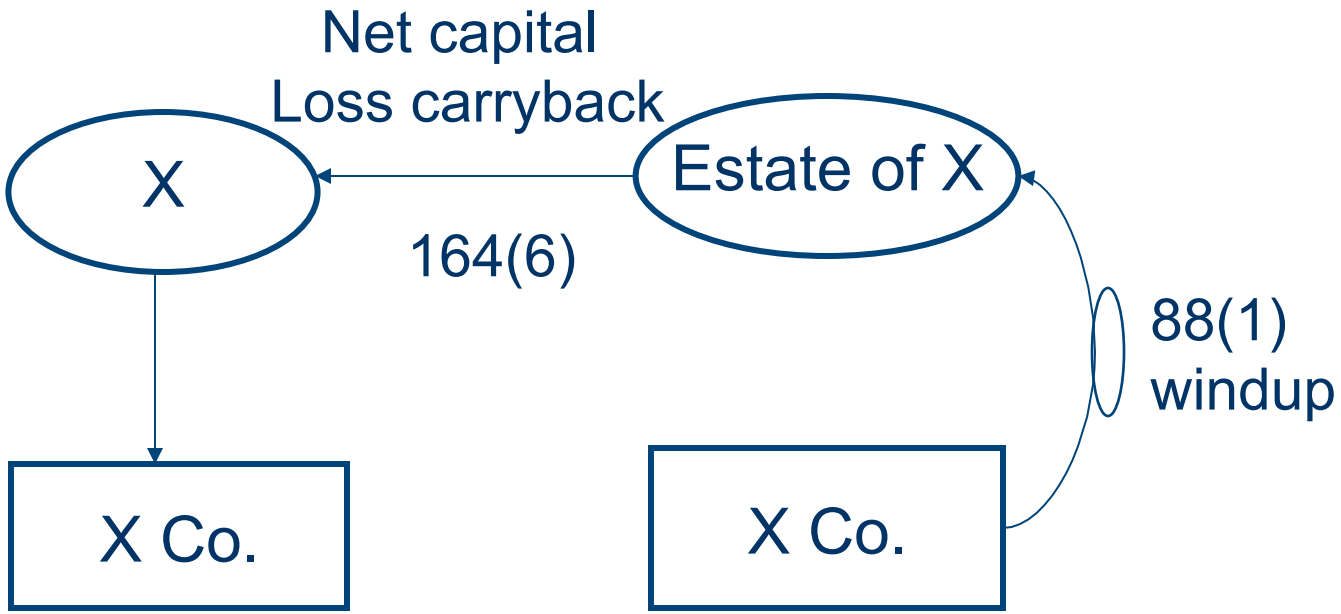
Capital Gain	$1.0 million
Tax	$250K

VERSUS

164(6) Strategy	
Tax in Corp.	58,333
Tax on Deemed Div	242,083
Reduced Cap Gains Tax	62,500
	$362,916

Double Tax Mitigation Strategies (cont'd)

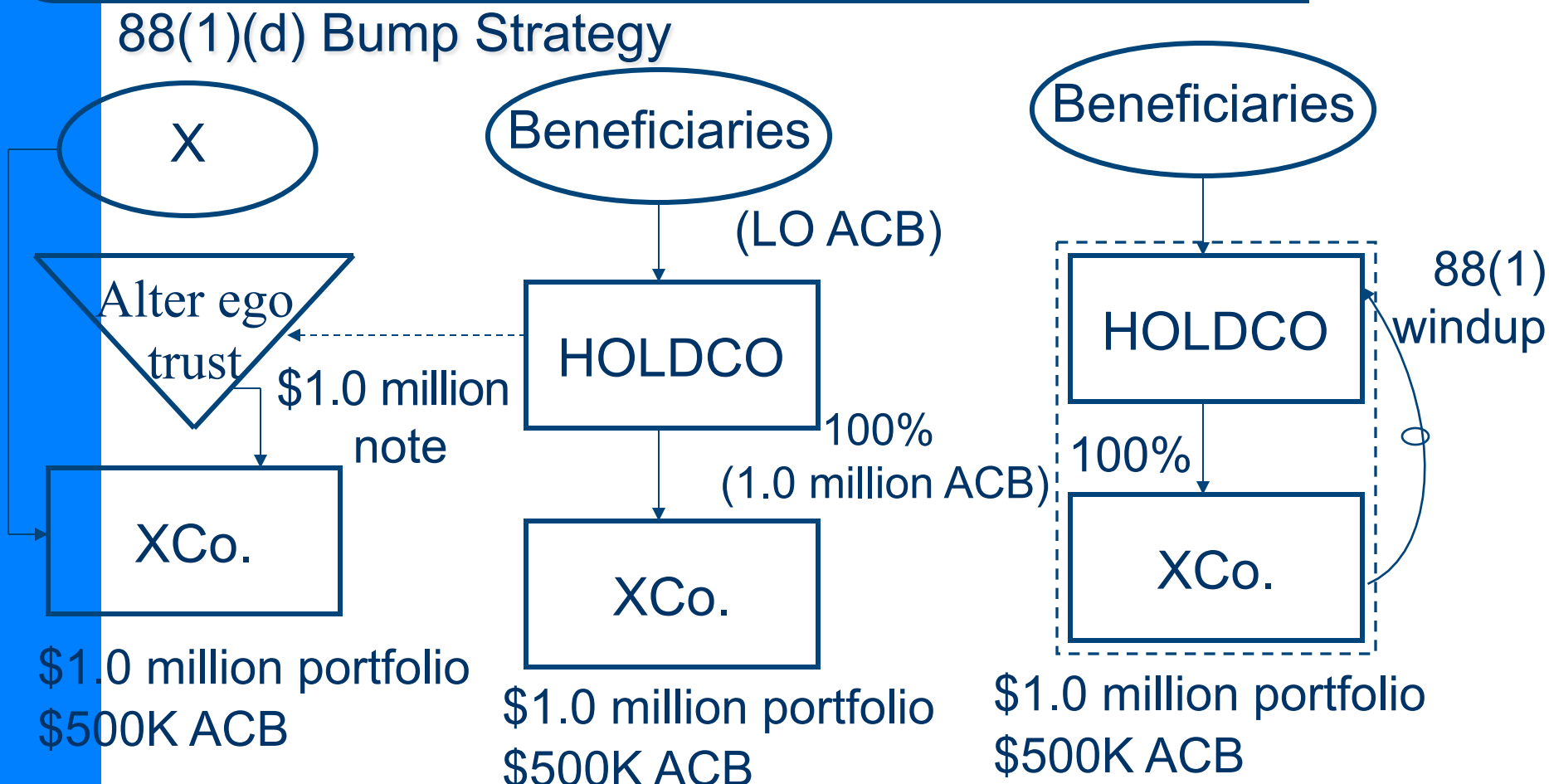
164(6) Election



$1.0 million portfolio
$500K ACB

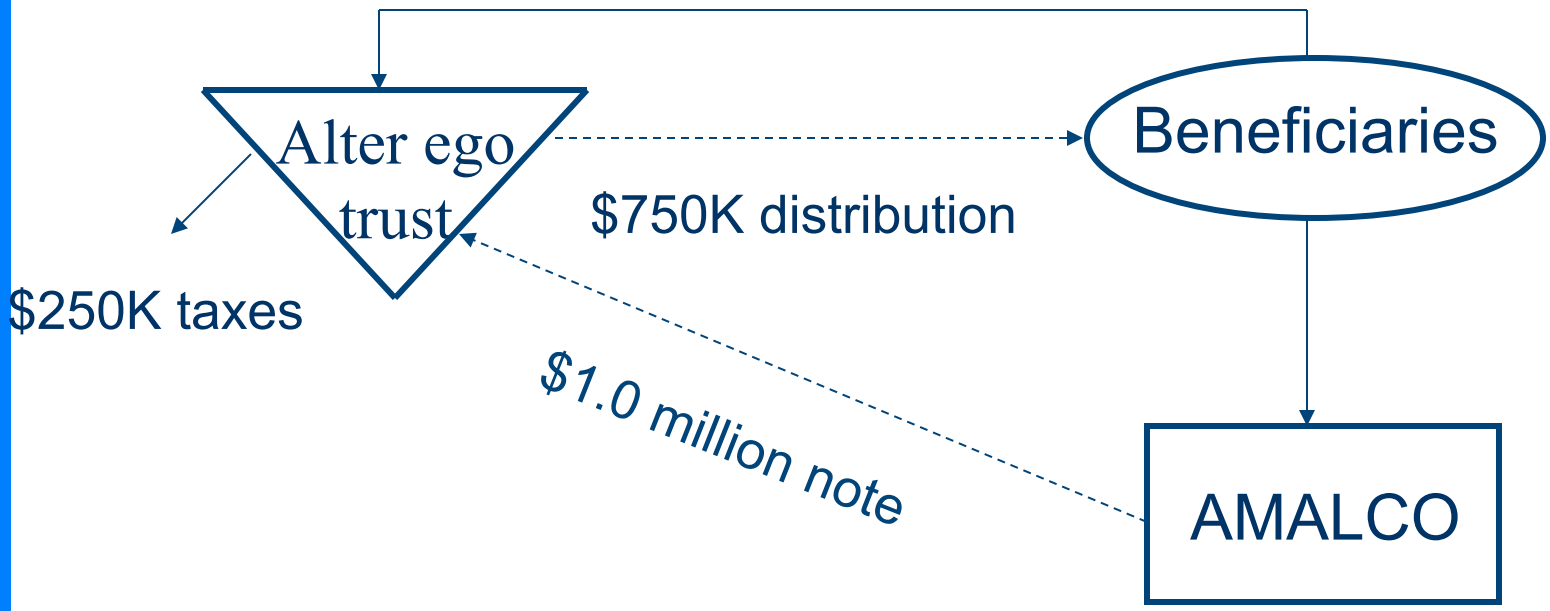
$1.0 million portfolio
$500K ACB

Double Tax Mitigation Strategies (cont'd)



Double Tax Mitigation Strategies (cont'd)

88(1)(d) Bump Strategy



$1.0 million portfolio
$1.0 million ACB

Double Tax Mitigation Strategies (cont'd)

	Do nothing	164(6) and 88(1) windup	Alter ego trust 88(1)(d) Bump
FMV	$1,000,000	1,000,000	1,000,000
Capital Gains Tax – Death	250,000	62,500	250,000
Corporate Tax	58,333	58,333	-
Distribution Tax on Windup	242,083	242,083	-
	550,416	362,916	250,000
Net proceeds to Beneficiaries	449,584	637,084	750,000

Questions?

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Thank-you!