



# Living Trusts and You

RBC Wealth Management®





*Trusts have been used for several hundred years and, naturally, the experts who work in this field have a unique vocabulary of terms. While we have not attempted to complicate this brochure with technical trust jargon, we may have used terms with which you are not familiar. Please use this glossary as a reference.*

**BENEFICIARY:** A person who receives a benefit under a trust, or for whose benefit a trust is created.

**CAPITAL:** The money or property that is transferred by the settlor to the trustee (trust in Quebec). Trust agreements generally distinguish between how the income of the trust will be handled and how the capital will ultimately be distributed.

**CAPITAL BENEFICIARY:** A beneficiary who is or may be entitled to the capital of the trust.

**DOMESTIC TRUST:** A trust that is established in Canada.

**ESTATE FREEZE:** An arrangement limiting the growth in value of the freezor's estate by diverting the growth, usually to a subsequent generation.

**INCOME:** The money generated on an ongoing basis through the investment of the capital (e.g. interest and dividends).

**INCOME BENEFICIARY:** The person or persons entitled to the income generated by the trust property until the time the trust is wound up. The income includes dividends and interest but does not generally include capital gains, which form part of the capital.

**LIVING TRUST:** A trust created by a settlor while he or she is still alive; also referred to as an inter vivos trust.

**REVOCABLE TRUST:** A trust that can be revoked by the person who created the trust.

**SETTLOR:** The individual who establishes a living trust.

**TESTAMENTARY TRUST:** A trust in a will, which takes effect only after death.

**TESTATOR (M) /TESTATRIX (F):** An individual who makes a will.

**TRUSTEE:** The person or institution who takes legal title to the property (in Quebec, the trustee has the control and the exclusive administration of the assets constituting the trust) and who is required to follow the terms of the will or the instrument creating the trust. The trustee may be a trust company or an individual.

**WILL:** A legal document, prepared by a person in compliance with formal requirements, which takes effect upon a person's death and states what the person wants to happen to his or her property after death.

## A LIVING TRUST CAN HELP YOU REACH YOUR FINANCIAL GOALS IN LIFE AND BEYOND

You've taken a lifetime to accumulate your wealth. Whether your estate is large or small, you want to make sure it is well protected and your assets are managed according to your wishes, both during your lifetime and beyond. You can protect your assets and achieve your goals through the use of a living trust.

In simple terms, a trust functions as an intermediary between you and your intended beneficiaries—a conduit used throughout your lifetime and/or after your death.

Unlike testamentary trusts, which are created under the terms of a will and take effect after death, living trusts are established during one's lifetime. They can continue operating after death or end at that time with instructions to distribute the assets directly to the beneficiaries.

And unlike a will, which may become a public document, the terms of a living trust remain confidential.

Depending on your financial, personal or tax objectives, you may benefit significantly from the advantages of a living trust.

## A LEGACY ESTABLISHED ON YOUR TERMS

As the diagram illustrates (page 2), a living trust is established when an individual is alive. It comes into effect as soon as the instrument establishing the trust is signed and the trust is funded.

The trust is funded when the assets are transferred from the settlor's name (the person or entity whose assets will form the trust) into the name of the trustee or co-trustees. The assets can be cash, stocks, bonds or almost any other form of property, if appropriate.

The trustee has legal title to the trust property under common law. Common law applies to all Canadian provinces except Quebec, which operates under the Civil Code. In Quebec, the trustee has the control and the exclusive administration of the assets of the trust.

One of the advantages of a living trust is that a settlor can choose to be the trustee\* or a co-trustee and maintain control or management of the assets for as long as he or she wishes while alive. Generally, there is no immediate tax advantage when establishing a living trust, however in certain situations, assets settled in a living trust may have tax consequences for the settlor.

A living trust can be revocable\*\* or irrevocable, depending on the preference of the settlor.

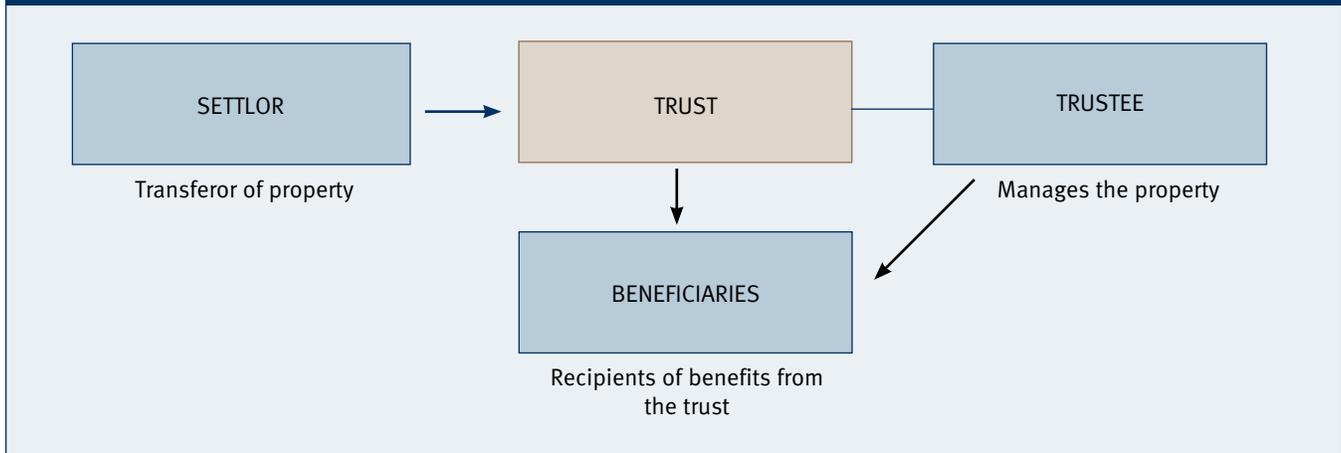
A revocable living trust can be terminated by the settlor at any time, although there may be corresponding tax implications for doing so.

\* The settlor cannot be the only trustee in Quebec.

\*\* Revocable trusts do not exist in Quebec.

Estate and Trust Services is the business name used by Royal Trust Corporation of Canada and The Royal Trust Company to identify the division offering estate and trust fiduciary services within RBC. Where settlors want to take advantage of the many benefits offered by Estate and Trust Services with respect to the role of trustee, they should appoint either the Royal Trust Corporation of Canada (outside of Quebec) or The Royal Trust Company (in Quebec).

## BASIC STRUCTURE OF A TRUST



### DIFFERENT USES, MULTIPLE BENEFITS

You can use a living trust in many different ways to achieve your personal objectives, add flexibility to your estate planning, or benefit from financial and tax advantages during your lifetime.

A living trust can help you:

- Provide income for your future while preserving your capital for distribution to the individuals you choose
- Donate to charity and enjoy a tax credit
- Provide for family members with special needs or disabilities that prevent them from managing their own financial affairs
- Reduce probate<sup>†</sup> costs and avoid delays associated with probate proceedings
- Reduce or eliminate executor fees for estate administration
- Transfer assets outside a will with confidentiality and discretion
- Freeze existing capital gains on appreciating assets in your estate and transfer any future capital gains to your beneficiaries

Although living trusts provide clear financial and estate planning advantages, cost-effectiveness can be relative to asset value. Domestic trusts with assets under \$500,000 require careful consideration, for example. We will work with you or your team of advisors to help identify and compare the potential costs and benefits of a living trust in your situation, taking into consideration the tax consequences to you, your estate and your beneficiaries.

Fees, including legal fees for preparation of the trust document, are incurred when a trust is established, while administration fees are charged on an ongoing basis. Fees are relative to the nature and complexity of your trust structure and the degree of specialized advice it requires.

<sup>†</sup> Probate does not apply in Quebec.

### LIVING TRUSTS PROVIDE ACTIVE SOLUTIONS

Living trusts have the flexibility and versatility to provide active solutions for a broad range of wealth management needs. The following are a few examples of the different types of living trusts.



## ALTER EGO TRUST: INCOME FOR LIFE

The terms of an alter ego trust must provide that all the trust's income be paid to the settlor during their lifetime, and no person other than the settlor may receive any capital from the trust before the settlor dies. Any remaining capital would ultimately be distributed to the trust's beneficiaries upon the settlor's death. Settlers may choose to name Estate and Trust Services<sup>1</sup> and a family member or friend as co-trustees; in this way, they can benefit from the professional advice of Estate and Trust Services and from valuable input on personal matters from the co-trustee. This type of co-trustee strategy takes care of the settlor's financial requirements, provides the security of sound financial insight and relieves the co-trustee of the burden of managing the trust assets alone.

The terms of the trust and the actions of the trustee can affect the tax consequences associated with an alter ego trust. These include whether income and capital gains may be taxed at the highest marginal tax rate in the trust or attributed back to the settlor to be taxed in his or her hands, regardless of whether or not amounts are actually paid to him or her.

To be eligible for an alter ego trust, you must be at least 65 years of age, a resident of Canada and be entitled to receive all the income of the trust during your lifetime. No other person can be entitled to receive any capital from the trust during your lifetime.

Sylvia was a lifelong academic and university professor who never married. She retired at 65, lived on her pension, then inherited both her parents' estates when she was in her early seventies. Her net worth increased to more than \$6 million. By her late seventies, she grew tired of the demands of managing her investment portfolio and looked into her options. As she had been estranged from her two brothers for quite some time, she had already decided to leave her assets equally among her nieces and nephews. She opted to transfer \$6 million of her investments to an alter ego trust. She named herself as the income beneficiary, with Estate and Trust Services<sup>1</sup> and a favourite nephew as co-trustees.

The trust agreement detailed exactly how Sylvia wanted her assets managed. Upon her death, the assets would pass outside her estate to her nieces and nephews, maintaining confidentiality, saving probate<sup>2</sup> costs and avoiding the potential for any challenges to her will relating to such assets. With Estate and Trust Services managing her trust investments, she was secure knowing that her assets would be protected for the next generation. She enjoyed the convenience of dealing with a Trust Officer and the comfort of having her nephew involved in major decisions.

<sup>1</sup> Naming or appointing Estate and Trust Services refers to appointing either Royal Trust Corporation of Canada or The Royal Trust Company.

<sup>2</sup> Probate does not apply in Quebec.



## JOINT SPOUSAL OR COMMON-LAW PARTNER TRUSTS: PROTECTION FOR COUPLES AND THEIR BENEFICIARIES

Joint spousal or common-law partner trusts have the same structure as alter ego trusts, except that the partners are both joint beneficiaries during their lifetimes.

Partners can be legally married spouses, individuals who have lived common law for at least one year, those with a child from the relationship, or same-sex couples.

To be eligible for a joint spousal or common-law partner trust, the settlor must be at least 65 years of age and a resident of Canada. The age 65 requirement does not apply to the partner.

The settlor and/or spouse must be entitled to receive all the income of the trust during their lifetime, and no person, other than the settlor or spouse, can be entitled to receive any capital from the trust during their lifetime.

Joe and Alice were in their late sixties when Joe was nearing a stage of incapacity due to illness. Jointly, they owned \$3 million in investment assets. Their son and his family were living in a different province. They decided to set up a joint spousal trust where they were initial beneficiaries and their son and two grandchildren were the beneficiaries after their death. They established the trust naming Estate and Trust Services<sup>1</sup> and their son as co-trustees.

Two years later, Joe passed away. Alice remarried when she was 73 and she continued to be the sole income and capital beneficiary of the trust until her death.

At that time, the trust assets reverted entirely to their son and grandchildren. Confidentiality was maintained and probate<sup>2</sup> was not required. If Joe had simply left a will with Alice as beneficiary or had jointly registered all assets with Right of Survivorship<sup>3</sup> with her, it would have been possible for her second husband to inherit all the assets, leaving nothing for their son and grandchildren.

<sup>1</sup> Naming or appointing Estate and Trust Services refers to appointing either Royal Trust Corporation of Canada or The Royal Trust Company.

<sup>2</sup> Probate does not apply in Quebec.

<sup>3</sup> Right of Survivorship does not apply in Quebec.

## CHARITABLE REMAINDER TRUSTS: GIVING TO CHARITY AND ENJOYING A TAX BREAK

Donating a residual interest in a living trust to charity is an excellent way to give what you want and get back what you need—in this case, a considerable tax break. This type of living trust is called a charitable remainder trust. If certain conditions are met, the fair market value of the charity's residual interest in the trust (the residue) may qualify for a donation tax credit when the gift is made. The allowable tax credit is based on the cash amount or market value of the property, your age, and current interest rates.

If, as the settlor, you do not fully use the tax credit in the taxation year in which you established the gift, you can carry forward the unused portion of the credit for up to five years.

Typically, the income earned from the assets in the charitable remainder trust is paid to you, and the capital goes to the charity after your death. This type of trust is most suitable for older people with a high marginal tax rate who want to make a charitable donation and can afford to relinquish ownership on a portion of their assets.



Maurice is a widower in his eighties who wanted to recognize the health care foundation that cared for his wife when she was suffering from Alzheimer's disease by making a gift to them. Although his first thought was to leave a bequest in his will, he consulted his lawyer and the foundation's planned giving director, who advised him he would enjoy greater tax and estate planning advantages with an irrevocable charitable remainder trust. The trust was established with Maurice as the income beneficiary and the foundation as the residual capital beneficiary. Estate and Trust Services<sup>1</sup> was named as trustee to administer the trust and invest the assets according to the directions set out in the trust agreement.

Maurice received an immediate tax credit based on the value of the residual interest in the trust (the residue), which he could use over the following five years. He will receive the income from the trust for the remainder of his life, and will pay tax on this income. The remaining assets will be distributed directly to the foundation upon his death. The trust assets will not become part of Maurice's estate and, as such, will not be subject to probate<sup>2</sup> fees.

<sup>1</sup> Naming or appointing Estate and Trust Services refers to appointing either Royal Trust Corporation of Canada or The Royal Trust Company.

<sup>2</sup> Probate does not apply in Quebec.



## ESTATE FREEZE: HOW TO BENEFIT THE NEXT GENERATION

If you own assets in a company that has had a consistent growth pattern over the years and is still expected to grow, you might consider using an estate freeze through the establishment of a living trust and a holding company. With this type of arrangement, you can “freeze” the current value of your shares while ensuring that future increases pass to the next generation (such as your children) or other beneficiaries. This strategy can also reduce charges related to the administration of your estate.

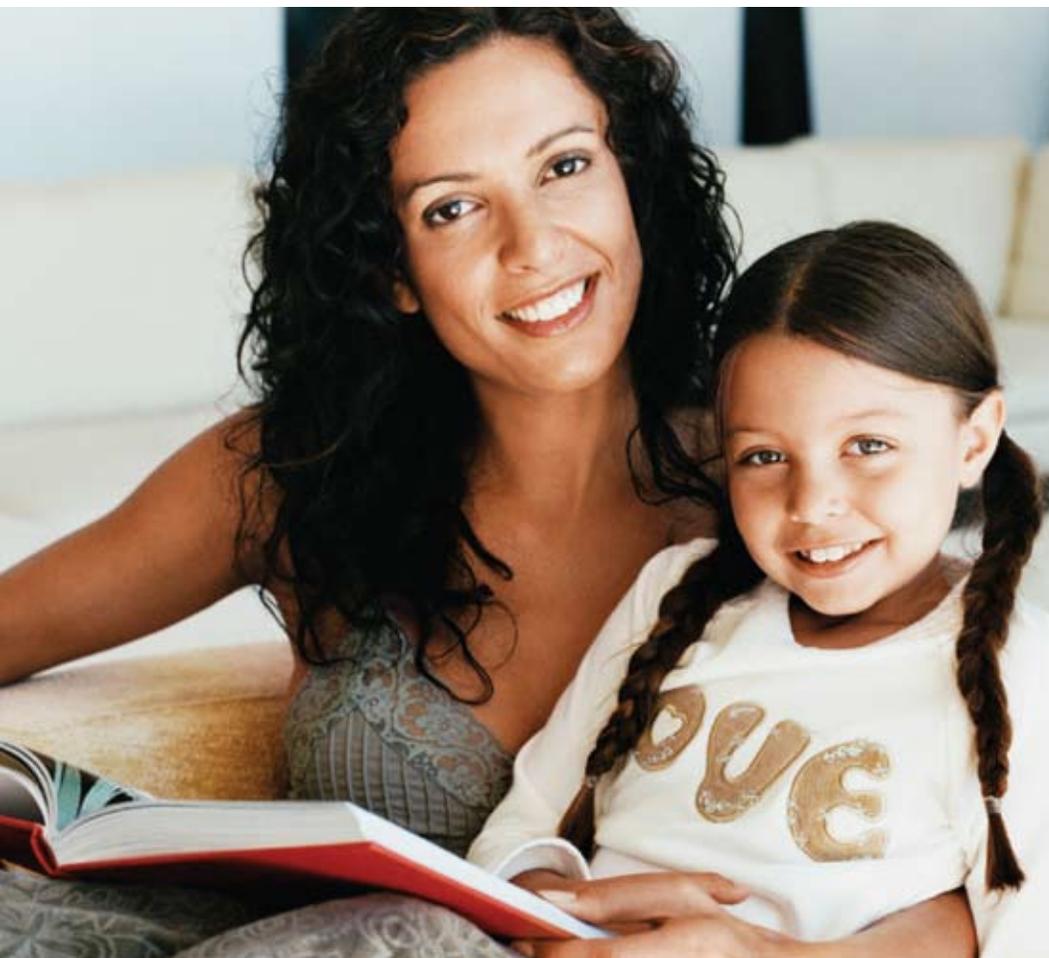
You should consult with your legal and tax advisors to obtain advice as to whether an estate freeze is right for you, given your circumstances.

Ben is the owner and manager of a successful IT company. The company has enjoyed substantial growth over the years and he and his wife, Karen, feel they are well established for their retirement. Ben has two daughters, both of whom are involved in the company, and he would like to ensure that all future growth in the value of the company benefits his children.

Ben’s accountant has suggested an estate freeze, whereby Ben transfers his shares in the operating company into a holding company in return for preferred shares that are redeemable at a fixed price. This is done on a tax-deferred basis. The fixed price will be the fair market value at the date the shares are transferred into the holding company. A trust is then set up to purchase the common shares of the operating company. The beneficiaries of the trust are Ben’s two daughters.

The shares are purchased at a nominal price. As the value of the preferred shares which Ben owns are fixed, all of the future increases in value will go to the owners of the common shares—who are, ultimately, the daughters.

When Ben passes away, the value of the shares will have grown significantly, but only his preferred shares—the ones whose value was frozen—are taxed at that point. The taxation of the gain on the common shares is deferred until either the trust or the daughters dispose of them. Ben has achieved his goal of passing continued growth in the company on to his children and avoided the potential issues that his executors (liquidators in Quebec) might face with the prospect of liquidating or mortgaging business assets to pay the tax at the time of his death.



## CAPITAL PRESERVATION WITH AN INCOME FOR LIFE: PROVIDING FOR THOSE WITH SPECIAL NEEDS

A living trust is an excellent way to provide income for life for individuals who are unable to manage on their own for any reason. This type of trust is typically used for very young people with disabilities and those with difficulties handling money.

If a trust is set up with the expectation that it will last for a long time—if the beneficiary is a child, for example—and the assets warrant it, it is a good idea to appoint a corporate trustee to ensure sound management of the trust's assets over the lifetime of the beneficiary.

Elizabeth is a widow whose husband was killed in an car accident that also permanently injured their six-year-old daughter, Justine. As the accident was caused by the other driver's negligence, the court awarded her more than \$2 million dollars, some allocated to her and some for Justine's lifetime care. Elizabeth is prepared to look after Justine as long as she lives, but is concerned about her daughter's future after she's gone. She has limited investment experience and worries that there won't be enough money for Justine down the road.

After receiving professional advice, Elizabeth established a trust for Justine. She appointed Estate and Trust Services<sup>1</sup> as trustee to manage the assets, preserve the capital and provide sufficient annual income to cover her daughter's needs. Elizabeth receives the income on Justine's behalf as long as she lives. After Elizabeth's death, Justine will be cared for by a relative or group home. The trust agreement directs that payments be made to whomever is caring for her.

The income and capital gains from a personal injury award trust, such as Justine's, are tax-exempt until the end of the year in which the beneficiary turns 21. After that, the exclusion no longer applies and any income and capital gains are taxed in the trust or in the beneficiary's hands at the beneficiary's personal tax rate.

<sup>1</sup> Naming or appointing Estate and Trust Services refers to appointing either Royal Trust Corporation of Canada or The Royal Trust Company.



## CHOOSING THE RIGHT TRUSTEE

The role of a trustee is an extremely important one, involving several key legal obligations as well as significant management and administrative responsibilities. Trustees are empowered to deal with the property according to the terms of the trust agreement and in keeping with trust law. Choosing the right trustee is essential to successful wealth preservation and peace of mind.

## ESTATE AND TRUST SERVICES: SPECIALISTS WITH AN UNPARALLELED REPUTATION

At Estate and Trust Services, we have served Canadians for over a century and are committed to client satisfaction and the highest business integrity. We provide a full range of will and estate planning, executor/liquidator, trustee and custody services.

One of the key benefits of using Estate and Trust Services as your corporate trustee is the security of knowing you are engaging experienced professionals to protect the interests and requirements of your trust. Our commitment, expertise and objective judgment can make a profound difference in the protection and maintenance of your assets.

### **We offer:**

- Extensive knowledge and understanding of trusts and relevant trust law
- Experience and expertise in all aspects of trust administration
- The ability to develop enduring and empathetic relationships with beneficiaries
- Understanding of the unique requirements of investing trust assets
- Trustworthiness, integrity and sound business judgment
- Commitment of time and attention
- Impartiality, advice and sympathetic consideration

## LEARN MORE ABOUT OUR FULL RANGE OF SERVICES

We look forward to discussing your specific needs and objectives. To learn more about our products and services, or to be connected with an Estate and Trust professional, please call 1-888-656-2741 or visit our website: [www.rbc.com/estateandtrustservices](http://www.rbc.com/estateandtrustservices).

This brochure is also available in French.

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