

Trusts can be and often are an integral piece of an individual's tax, financial and estate planning process, particularly for business owners. Historically, trusts have been used for a variety of purposes, including:

- Income splitting;
- Reducing taxes;
- Protecting assets;
- Utilizing capital gains exemptions; and
- Transferring assets to select beneficiaries

The 2014 Federal Budget (the “**Budget**”) has proposed several measures that, when they come into effect, will change the taxation of trusts in Canada. Of particular note is the proposed elimination of the graduated tax rate and other tax benefits for *testamentary* trusts. These changes may drastically alter the way in which estates are administered in Canada.

Despite the tax changes proposed in the Budget, trusts will continue to be a very effective tool for financial planning. What the Budget does illustrate, is that it is important to be aware of changes in trust law and perhaps adjust your financial and estate plans accordingly.

### **What is a testamentary trust?**

Generally speaking, there are two (2) types of trusts:

- (1) Inter-Vivos – a trust created during the creator of the trust's lifetime; and
- (2) Testamentary – a trust created on the creator's death, for example under a Will.

Currently, inter-vivos trusts are taxed at the top personal marginal tax rate (up to 50% in 2014 depending on the province). In contrast, a testamentary trust is taxed at the graduated personal marginal tax rates. As a result, testamentary trusts provide (at least for the time being) an opportunity for tax savings for its beneficiaries.

The proposed changes in the Budget discussed here only affect testamentary trusts.

### **What are the proposed changes in the Budget?**

As of the 2016 taxation year, testamentary trusts will no longer receive preferential tax treatment and will be taxed at the top personal marginal tax rate.

The *estate* of a deceased person will still qualify for graduated tax rates, but only for 36 months following a death. After this time period, the top personal marginal tax rate will apply. This means that as soon as the assets of the estate are fully administered or transferred into a testamentary trust created in a will (i.e. by transferring funds from the estate into a trust bank account) the top marginal tax rate will apply.

The 36 month allowance of graduated tax rates for estates is recognition by the government that the time it takes to administer an estate can be lengthy; but it is not indefinite. We highly recommend speaking with us directly as to how best to ensure you take advantage of the tax savings that can be achieved in the 36 month grace period.

In addition to the elimination of the graduated tax benefit, the Budget further proposes that testamentary trusts will lose the following benefits:

- Exemption from income tax instalment rules;
- Exemption from calendar year-end;

- The basic exemption in computing alternative minimum tax; and
- Ability to make investment tax credits available to beneficiaries.

### **How does this affect the use of trusts?**

The changes proposed in the Budget do not mean that testamentary trusts should be avoided. Testamentary trusts still provide significant tax advantages, help control the distribution of your assets and ensure your wishes are honoured after death.

Further, the Budget does not make any changes to the taxation of inter-vivos trusts. Inter-vivos trusts are very common and serve a multitude of purposes that can greatly benefit an individual.

The Budget however, is a reminder that you may want to re-examine your financial goals and consider how the proposed changes may affect you. Testamentary and inter-vivos trusts are very powerful instruments and you may be able to benefit with solid planning and the proper advice.

### **Other Proposed Changes:**

Other changes proposed in the Budget include:

- Changing the tax treatment of charitable donations made as a consequence of death. These changes are intended to increase flexibility in the application of charitable donation tax credits;
- Eliminating the 60-month exemption for non-resident trusts; and
- Expanding the definition of 'split income' to make it harder for taxpayers to shift income to lower-taxed minor individuals through the use of private companies, partnerships and trusts.

It is never too early to begin thinking about financial, tax, and estate planning goals. The more familiar you are with the options available, the better you may be able to determine the best course of action for you.

If you wish to learn more about the proposed changes in the Budget or if you have estate and trust planning needs, the members of our Firm would be happy to discuss your options with you.

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### ***About Houser Henry & Syron LLP***

For over 75 years, Houser Henry & Syron has helped entrepreneurs and private companies of all sizes grow and prosper. We provide a range of business law services - from assisting with day-to-day legal requirements to providing strategic counsel on highly complex transactions. We are uniquely positioned to provide high-quality legal advice, tailored to the specific needs of our clients, at a reasonable price.