Why Trusts Are an Essential Tool
For Wealthy Families

One way for high net-worth and ultra-high-net-worth families to carve out an equal helping of the estate planning pie – and to reduce tension among family members – is with trusts. Wealthier families have long used these structures to maintain more control over their legacy and ensure money is distributed to family members according to the wealth creator's wishes.

What is a trust?

A trust is a legal arrangement where money is kept in an account and administered by a trustee. The person opening the trust, also known as the settlor, can dictate exactly how that money is administered. There are two main kinds of trusts in Canada.* The first is an inter vivos trust, which allows you to transfer assets during your lifetime. The other is a testamentary trust, which is formed after your death based on instructions in your Will. Deciding between the two approaches depends on what you're trying to achieve.

Trusts have a range of applications based on the needs of a family. For families with young children, it can be a way to not only protect but control the timing and size of the distributions or provide for beneficiaries who may not have the mental capacity to manage the funds themselves.

If you have a business or other assets you'd rather keep from public view, trusts can help keep your affairs private, unlike a Will, which is subject to a public probate process.

Why consider a trust?

1. Encourage financial independence

If you're looking for flexibility over when a beneficiary receives a distribution or the amount of the payment, then a trust can help here, too, as the needs of your beneficiaries can change over time. For example, if you have a grown child who is financially independent and is following a successful career path but suddenly becomes ill, a trust may be a solution. Instead of giving your child an inheritance to do with it as they wish, you can establish a testamentary trust in your Will so that a professional could manage the assets on their behalf and ensure your child has enough money to meet their daily needs and expenses.

Many people also use trusts in the opposite scenario. To ensure children gain independence, they set up a trust to distribute their wealth over time, which could then keep the beneficiaries motivated to work and provide for themselves. This also gives the beneficiaries time to work with an advisor or trust professional to learn how to manage that wealth.

2. Avoid family disputes

A trust can also help quiet squabbles over assets, such as the family cottage. Perhaps one person uses the cottage more, so it may make sense to give it to that child, but because of its sentimental value, no one wants to give it up entirely. Transferring the cottage to a trust can be one solution. It's often an easier way to get kids to share a vacation home than letting them figure out the details themselves. That's because you can dictate a set of instructions covering things such as who gets to use it when and how taxes and maintenance are covered. The trust will pay the expenses, either out of the trust itself or by having the trustee collect cash from the kids.

Trusts can also be useful in blended families, especially if one parent has children from another marriage. To ensure all the assets aren't comingled in the new relationship in a way that may cut out children from a previous relationship, some spouses may choose to set up a spousal trust. Unlike a Will, this type of trust provides a stream of income to a surviving spouse from a second marriage while ensuring that the assets in the trust are passed on to the children from the first marriage.

3. Tax treatment of trusts

Families also look to trusts to help minimize taxes, since the assets placed in the trust are not part of your estate – although rules differ by province. Still, tax will need to be paid. If you set up a family trust during your lifetime, you will have to pay tax on any accrued gains when you transfer your assets into the inter vivos trust. With proper planning, once the assets are in the trust, any future growth can be taxed in the hands of the beneficiaries when they receive distributions from the trust.

If you're in a high tax bracket and want to help your children or grandchildren in a lower tax bracket with things like education or a home down payment, then you could set up an inter vivos trust that names them as beneficiaries. Any income that is paid to the beneficiaries would be taxed in their hands. Of course, you could also name them in a Will, but your gift could miss out on years of potential tax savings during your lifetime.

4. Build trust through transparency

There are many scenarios where trusts make sense, but there also are several things you must consider before you sign any paperwork with your lawyer. For instance, before giving a substantial gift through a Will or a trust, it's important to talk to your beneficiaries to make sure they can responsibly manage that wealth.

Some firms, including BMO Private Wealth, can help you prepare for a family meeting or even facilitate a conversation with your loved ones. These discussions are less about explaining who might get what and more about making sure the family understands your wishes and why you are structuring the transfer of your wealth in a certain fashion. You don't have to disclose the value of your wealth at these meetings; it's an opportunity to teach your children about managing wealth. That transparency may also help mitigate conflict among your beneficiaries after your death.

For more information, please speak with your BMO financial professional.

BMO Private Wealth

* There are significant differences between trusts created under common-law and those created under Quebec's Civil Code. Although this publication outlines some of the main differences between the common-law and the Civil Law in Quebec, Quebec residents are advised to obtain separate legal advice addressing the trust law under the Quebec Civil Code.

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