

## When is a Trust Really a Trust?

Trusts are simple arrangements whereby the settlor of the trust places property in it for the benefit of one or more beneficiaries. The settlor will also appoint a trustee whose job it is to ensure the terms of the trust are followed. These terms and any other rules required for the operation of the trust are established by the settlor.

From a wealth planning perspective, the difficulty with understanding trusts stems from the fact that there are both legal and tax issues that must be satisfied in order for an arrangement to truly be considered a trust. This article will discuss these issues.

### Inter-Vivos & Testamentary Trusts

Trusts occur in two forms, either Inter-Vivos or Testamentary. Inter-Vivos (living) trusts are set up by an individual (referred to as the settlor) while he/she is alive, with the intention that the property placed in the trust will be managed by the trustee according to the terms of the trust. Alter Ego, Joint Spousal and even Informal (Oral In-trust accounts) trusts are different types of inter-vivos trusts. Information on Alter Ego and Joint Spousal trusts can be found on SC Online at PCFS/Wealth Planning.

Testamentary trusts differ from inter-vivos trusts in that they are only created upon the death of the settlor and are done so through the settlor's will. Testamentary trusts are created for a number of reasons. One of the more common is to help reduce a surviving spouse's tax liability by splitting income between assets owned directly by the spouse, and assets held by the testamentary trust. The type of trust that accomplishes this is referred to as a Spousal Trust.

### Informal (Oral) Trusts

Informal trusts (sometimes referred to as "oral trusts") occur where funds are set aside for the benefit of another "in-trust" without the benefit of a formal trust deed or indenture. These in-trust accounts are usually created for the benefit of a minor child and are typically labeled as "Jane Doe In-Trust for John Doe". Due to their informal nature, these types of accounts, although referred to as such, may not actually be trusts. Establishing a trust involves more than just placing the words "in-trust" on an account application.

### The 3 Certainties of a Trust

From a legal perspective, three "certainties" must exist in order for a trust to be recognized under law. These certainties are known as the Certainty of Object, the Certainty of Subject Matter and the Certainty of Intention. These certainties must be present for any type of trust to be recognized by both the courts and the Canada Customs and Revenue Agency.

The Certainty of Object refers to the objectives of the trust in so far as it must be possible to ascertain who is to benefit from the trust i.e. what is the objective of the trust. The Certainty of Subject matter refers to the fact that a trust must have in its possession, an identifiable asset that has been conveyed by the settlor of the trust. Lastly, the Certainty of Intention demands that the settlor clearly had the intention to pass the asset on to the trust with the explicit intention of having a trust created.

### **Are In-Trust Accounts Considered Trusts?**

A trust exists as long as the three certainties exist. A trust does not have to exist in writing, but it is highly recommended that written evidence exists that documents the terms of the trust. This is particularly an issue where in-trust accounts are concerned.

Due to the informal nature of in-trust accounts and the fact that very little in the way of written evidence is established when they are created, many of these accounts are not considered actual trusts. The problem is twofold. The first has already been discussed. That is, since no written evidence exists, it is difficult to establish that the three certainties have been met. It is not impossible to do, just difficult.

The second problem is a little more technical and has to do with the income splitting benefits that are usually associated with setting up in-trust accounts.

Section 75(2) of the Income Tax Act (ITA) states that if under the terms of the trust, the property in the trust:

can revert back to the settlor or pass to some other person or

the property in the trust cannot be dealt with without the settlor's permission,

then any income or capital gain from the account becomes the settlor's.

Since in-trust accounts are rarely put into written form, The Canada Custom and Revenue Agency's position is that it will be difficult for the parties involved to establish that the informal trust does not contravene section 75(2) of the act.

As an example, parents and grandparents who establish in-trust accounts don't typically understand the limits imposed on them if these arrangements are truly to be considered trusts. Many believe they can take these assets back at their own discretion. Believing that this is possible, not to mention actually doing it, would indicate that the certainty of intention had never been met. As well, the conditions of 75(2) would not have been met and would therefore make any tax advantage that would have otherwise been gained, null and void.

In conclusion, although the setting up of a trust can be a rather straightforward matter, it is imperative that both IEs and their clients fully understand the implications of setting up trusts and trust accounts, to avoid any future misunderstandings, tax or otherwise.

*Note: The above article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with their personal tax advisors before taking any action based upon the information in this article.*