“Why you may need or want to set up a trust in your estate”
By Brenda Bouw

Trusts are considered beneficial because they give parents control over who gets their assets, how much and when.

Parents may have little say over how their adult children spend money, but they can control how much of their wealth they pass down by setting up a trust.

Trusts are a common investment strategy used by high-net-worth individuals looking to transfer all or parts of their assets to their children or grandchildren. They can do it when they're alive, through what's called a living trust, or include it in a will, which is a testamentary trust.

Demand for both types of trusts is on the rise as baby boomers get older and starting thinking about ways to pass on their wealth, and in some cases their companies, to the next generation.

"It's a growing business," says Elizabeth Dorsch, chief executive officer of BMO Trust Company and national director of trust and estates services at the bank.

Trusts are considered beneficial because they give parents control over who gets their assets, how much and when. Trust assets are not subject to probate fees and are protected from creditors or other legal battles. The contents of a trust also remain private, unlike a will, which becomes a public document when an estate goes into probate, which is when a will is legally validated.

Many parents are choosing to set up trusts while they're still alive because they want to see their children benefit from the money, "but in a controlled environment," Ms. Dorsch says. If they own a business, they may use a trust as part of their succession plan.

A common estate-planning strategy is to do an estate freeze with a discretionary family trust, which locks in the current value of an investment portfolio or a business. A freeze allows parents to transfer future growth of the assets to the next generation, while still retaining flexibility as to how the assets will ultimately be divided among the children.

The freeze can be done with passive assets, such as securities or real estate, or an active business, says Mark Brender, a tax lawyer in the Montreal office of Osler, Hoskin and Harcourt LLP.

"It gives them a great deal of flexibility because the founder doesn't need to make a decision immediately about how the assets are divided," Mr. Brender says.

Parents often opt for an estate freeze when they've accumulated enough wealth to keep them happy for the rest of their lives. There's also the tax deferral benefit.

When freezing the assets, the parents will lock in any accrued capital gains, which would typically be taxed on death. Growth on future gains will not be taxed until the trust sells its stake, or after 21 years, which is when what's known as the "deemed disposition" of a trust kicks in. If the trust distributes the assets to the children before the 21st anniversary, the tax is deferred until the kids sell or on death. Many small business owners and family members can also potentially benefit from the one-time capital gains exemption, which is $835,716 in 2017.

If parents decide to do nothing, and their assets continue to grow, so too will the tax on their estate when they die, which can be significant.

"As with all tax planning, there are a lot of complex legal and tax issues that need to be addressed with trusts to ensure that they're implemented properly to achieve the desired results," Mr. Brender says.

People over the age of 65 may also want to consider setting up an "alter-ego trust" or a "joint-partner trust," which can be done without having to pay immediate capital gains tax on the transfer, says Jamie Golombek, managing director of tax and estate planning at CIBC Wealth Strategies Group.

"In order to qualify as an alter-ego trust or joint-partner trust, you (or you and your spouse or joint partner, in the case of a joint partner trust) must be entitled to all of the income and no one other than you (or you and your spouse or joint partner) can be entitled to capital of the trust during your lifetime," Mr. Golombek said in a recent note to clients. "You can continue to maintain control of the property through the trust if you are the trustee."

There are disadvantages to trusts, including upfront costs for setting them up and ongoing compliance costs. People with a trust must also file an annual trust tax return.

"In my experience, the benefits of setting up a family trust outweigh any costs," says Pam Prior, a partner at KPMG Enterprises. "You need to set them up properly, otherwise they don't work."