



Testamentary Trusts – Acting as a Trustee

Definition of a "Trust"

One person or persons ("trustee") holding something, such as investments, bank accounts or other property, for the benefit of someone else ("beneficiary"). A trust set up on the death of the trustee's creator ("settlor") is a testamentary trust. A trust set up during a settlor's lifetime is an *inter-vivos* (meaning 'between the living') trust. The most common way of creating a testamentary trust is by including it in the settlor's Will. This brochure provides information about testamentary trusts.

Why Create a Testamentary Trust?

Some of the most common reasons for creating a testamentary trust include:

- to protect a beneficiary who does not handle money well,
- to protect a beneficiary who receives a disability pension such as Ontario Disability Support Plan (ODSP),
- to allow a beneficiary to save income taxes,
- to provide creditor protection for a beneficiary,
- to allow income-splitting and tax savings while retaining control of trust assets,
- to allow a second spouse to benefit from the trust during his or her lifetime while ensuring that any remaining trust assets eventually end

up in the hands of the children of the settlor's first marriage.

Obligations of a Trustee

The trustee of a trust has an overriding obligation to manage the trust assets for the benefit of the beneficiary or beneficiaries of the trust. The trustee must ensure that the trust assets are managed prudently and that any investments comply with the requirements set out in the Will or other trust document and with any relevant legislation (such as the *Trustee Act*). The trustee should work closely with a professional financial advisor to determine how best to invest and manage the trust assets. This is of particular importance where there are substantial trust assets. Depending upon the terms of the trust and other factors, the financial advisor's fees may be payable from the trust or may form part of the trustee's compensation. Trustee compensation is the payment allowed to a Trustee for the work that he or she performs in managing the trust and dealing with the trust beneficiary.

Compensation and Record-Keeping

For more information about the detailed accounting required and trustee compensation, please see our brochure entitled *Estate Accounting for Estate Trustees and Attorneys*. The comments provided here are general information. Unless the trust document says otherwise, a Trustee is entitled to be paid compensation. If a trustee takes compensation, it is taxable income to the trustee and must be reported on his or her income tax return.

The trustee must maintain up-to-date,

detailed records tracking all transactions of the trust including receipts, disbursements, investments, etc. The records, referred to as the trust accounts, must be supported by documentation such as receipts, bank statements and investment statements. It is also recommended that a trustee keep copies of correspondence relating to the trust and a journal of all time spent by the trustee in carrying out his or her trustee duties. These records may have to be provided to an appropriate authority on request.

Trust accounting differs from tax accounting in several respects. For example, if the trust earns income which is not paid out to the beneficiaries of the trust, subject to applicable tax laws, the income may be returned to the trust as *capital*. This income needs to be tracked under trust accounting rules. It is advisable to seek professional advice or assistance with complicated trust accounting matters. A lawyer who specializes in estate and trust work or an accountant familiar with the special requirements of trust accounting can help set up the accounts and provide short-term ('start-up') assistance to get the trustee off to a good start.

Audit or Review

Canada Revenue Agency (CRA) has the right to audit the accounts of any trustee. CRA requires that accurate and up-to-date records of the trust be kept. An audit is disruptive at the best of times. However, it will be especially time-consuming if the accounts and supporting records provided to CRA are incomplete or inaccurate.

Ontario's Public Guardian and Trustee (PGT) may also have the right to review the accounts of a trustee. This can occur as a result of a complaint being made to them. Most often complaints are made by individuals who have concerns about the management of the trust, such as the beneficiary of the trust, a relative, care worker or someone from a public agency.

Any individual who has an interest in the assets of a trust has the right to demand that the trustee "pass his or her accounts". This is a court process where a judge approves the accounting records of a trustee. Please see our brochure entitled *Passing of Accounts* for more information.

Tax Returns

The trustee of a trust must file annual T3 trust returns within 90 days of the trust's year-end if the trust has income to report. Although many trusts have a 'year-end' of December 31, a testamentary trust may have a different year-end. 'Year end' is the date that the trustee has chosen in consultation with a tax advisor and which cannot change once selected (unless a change is approved by CRA). The first year-end date can be any day of the year up to one year after the date of death of the settler (the person who created the trust). To simplify the trust accounting and record-keeping, most trusts have a year-end date which is the end of a month, the end of a quarter or the end of a year. It is strongly recommended that the trustee hire a tax accountant familiar with trust tax returns to ensure that tax filing rules are complied with and that the trust is as tax-efficient as possible. The accountant's fees are generally payable out of the trust.

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If you have questions or if you would like more information, please call us at 613-836-9915. This brochure is not intended to be legal advice but contains general information. Please consult a lawyer or other professional to determine how the information in this brochure might apply to you.

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