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Marmer Penner Inc. Newsletter

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TRUST INCOME ISSUES: A PRIMER

In our April/May newsletter, we discussed issues relating to the valuation of a trust interest. In this newsletter, we highlight issues pertaining to income determination when a spouse is a beneficiary of a trust.

The terms of a trust may spell out specifically what each beneficiary is entitled to, or, it may be left to the discretion of the trustee(s). If it is a discretionary trust interest, the determination of income entitlement becomes more complex.

There is no simple answer in determining income from a trust. Each situation involving a trust is different and the income available can range to 0% to 100% of the trust income. When assessing the income available from a trust, we generally assess both the *access to* and *control over* the income earned within a trust. Access usually requires that the spouse is a beneficiary of the trust or that the spouse can change the beneficiaries so as to name themselves as a beneficiary. However, this is not always the case and is dependent on the facts of the situation. Assessing control over the income of a trust requires an understanding of the relationship between the beneficiary spouse and the trustee(s).

For both access and control, it is typical to review the history of payments from a trust in order to assess a spouse's historical entitlement to income. Sometimes, even though a spouse may not be a beneficiary and may not be a trustee, the spouse can have the ability to

direct the income to the trust, in which case, the income available to the trust should be included in the spouse's income. Perhaps the best example of this is a professional (doctor, lawyer or accountant) who sets up their practice to pay a management company which then distributes payments to a family trust that has been set up to own the management company. In this case, the income available to the trust comes from the professional's practice. In the absence of the family trust and management company, the practice (and therefore the practitioner) would have reported higher income.

When completing the Form 13.1 of a spouse with trust income, it must be determined whether the payments are being made from the trust on a pre-tax or after-tax basis. Usually, a trust distributes its income on a pre-tax basis to its beneficiaries, each of whom are required to receive a T3 slip from the trust. This is why it is important to obtain the T3 summaries and T3 supplementaries that have been filed by the trust – these tax filings allow for a review of the historic payments to the beneficiaries and allow confirmation of the tax status of the payments. Sometimes, a trust pays its own expenses and income taxes, and then distributes the after-tax income to its beneficiaries. Where a spouse receives after-tax monies from the trust, it may be necessary to gross-up the payments to reflect the fact that they are being received in after-tax dollars.

From time to time, you may see evidence of trusts that are set up with the specific intent to hide assets and understate income. Establishing the existence of trusts set up for this purpose generally requires forensic accounting expertise. If there is suspicion of trusts set up for the purpose of defeating a spouse, the initial request for disclosure should attempt to establish the existence of such trusts.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.