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Do You Have a Trust? Don't Forget About the 21-Year Rule!

Trusts can be a great tool for tax, estate and succession planning. If you already have set up a trust, don't forget about the "21-year rule", which may sometimes be overlooked during the life of the trust.

In general, under the Income Tax Act, every 21 years a trust is deemed to have sold all of its property at fair market value for tax purposes and the trust must pay tax on any accrued gains. Without careful attention to the age of a trust, any benefits that you may have intended to achieve by setting up the trust can potentially be overshadowed by a significant tax liability.

Consider the consequences: assume that a trust holds shares worth $100 on its 21st anniversary that originally cost $10. The trust would be subject to tax on a $90 capital gain, even though it still owns the shares. This "prepayment" of tax could potentially create a liquidity issue for the trust.

Fortunately, with advanced planning, you can take steps to avoid a nasty tax bite before 21 years have passed. One way to avoid this situation, provided that the trust agreement has been properly drafted, is to distribute the assets of the trust to its beneficiary(ies) at the trust's original cost base. In our example, the trust could distribute the shares to its beneficiary(ies) at the original $10 cost. Now the beneficiary(ies) would have personal ownership and control over the assets and would therefore be responsible for paying tax on the $90 capital gain when the shares are eventually disposed of. Other solutions are available but may be more complex and require greater pre-planning with the assistance of an accountant and/or lawyer.

Don't forget about the 21-year rule. We recommend scheduling a meeting at least one year in advance of the 21st anniversary of the trust to ensure that the appropriate steps can be taken for your particular situation.

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