SMALL BUSINESS

Family trust can help aging parents

Owners can distribute money from a business through fund, resulting in less tax on income transferred

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GLENN BAGLO/PNG
Tina Lee, owner of Leemore and Associates Real Estate Appraisers, says she has found that a family trust is the best way to provide income for her mother.

When real estate appraiser Tina Lee established a family trust for her kids, she had no idea she'd one day use the same trust to help support her mom.

She understood a family trust is a good way for a business owner to distribute income to other family members, but like an increasing number of adult children with aging parents, she is now looking at the old structure with new eyes.

Lee's mom, June Wing, 63, had always been frugal, but she is a former stay-at-home-mom whose husband had died some years ago. In recent years, she realized her savings were unlikely to last her lifetime. She'd heard about reverse mortgages on the radio and asked Lee what she thought.

"Part of her wants to leave a bit of a legacy," said Lee, owner of Leemore and Associates Real Estate Appraisers. "When she does die, she'd like to leave us her real estate and jewelry and other knick-knacky things. When she understood she'd lose a fair amount of equity in the property, the reverse mortgage wasn't as appealing."

Together, mom and daughter explored multiple options. Wing had worked in Lee's busy 10-appraiser business as a bookkeeper for several years, but now Wing wanted to retire.

They considered selling Wing's townhouse and having her rent, but after a lifetime in her home, Wing wasn't enthusiastic about that.

Neither were Lee or her mother keen on moving in together.

"We enjoy our independence and our freedom and she enjoys hers too," said Lee, who has a busy family life with two young children. "She didn't want to be in the basement suite and she thinks we're noisy. It just wouldn't work."

Ultimately, they got around to talking about the family trust.

"Had [my financial advisers] not brought it up, we probably wouldn't have thought about it," Lee said.

For a business owner, using a family trust to help a retired parent "could be very tax efficient indeed," said Phil Tippetts-Aylmer, an adviser with Nicola Wealth Management who works with Lee.

Creating a family trust that holds shares in a business means the business owner can flow money from the business, through the trust, to the low-income retired parent who will then pay tax on that money at a low marginal tax rate, Tippetts-Aylmer said.

Simply topping a retired parent's income with after-tax, out-of-pocket money can be much more expensive because the business owner may well have paid tax at a marginal rate of 43.7 per cent. With the lowest marginal tax rate at 20 per cent, the family trust strategy can cut the family tax bill on that money in half.

The family trust strategy only works for business owners who have excess income and a low-income parent or parents. It works particularly well if the business profit is $500,000 or less, Tippetts-Aylmer said. It works best for adult children looking to transfer money to their retired parents on a regular basis or if it is a significant amount. The arrangement and maintenance cost are probably not worthwhile for those who just buy a parent a car or a vacation, Tippetts-Aylmer said.

Expect to pay about $2,000 to $3,000 in legal fees to establish a family trust. The business owner will likely also need to restructure the share ownership of the company because a trust has to own shares so dividends (the money) can flow from corporation to trust to beneficiary. If the business has a family trust, adding a parent as a beneficiary is a relatively simple matter. There are also annual tax reporting costs. Lee pays about $400 a year in additional accounting fees.

It's best to ask an accountant to do a cost-benefit analysis to see if a family trust would be worthwhile, Tippetts-Aylmer said. It's important to consider all of the retired parent's income not only now but in the future, he said. Sometimes older parents have more T4 income than they realize and while they may need help financially, a trust may not be worthwhile. Part-time work, private company pensions and withdrawing income from RRSPs all increase taxable income.

An aging parent will also typically received a bump in retirement income at age 65 with benefits such as CPP, OAS and perhaps GIS. In some cases, giving a parent more taxable income will lead them to lose some of these government benefits.

Lee's been using her family trust to help her mother for two years.

"We wanted to give her some kind of security," Lee said. "We had the means of taking care of her. This also gives her some sense of independence. She lives on her own and is social and outgoing.

"Because she's not earning an income, she's able to make use of the dividend without triggering much tax at all and we're able to be taxed at the small business rate, which is much lower than if I were to take it out as income, then give it to her.

"She was a little uncomfortable at first and it took some convincing, but it's a win-win situation for both of us and she doesn't have to move in with us, which is right on both ends. Eventually, we'll be able to use the trust for the children."

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