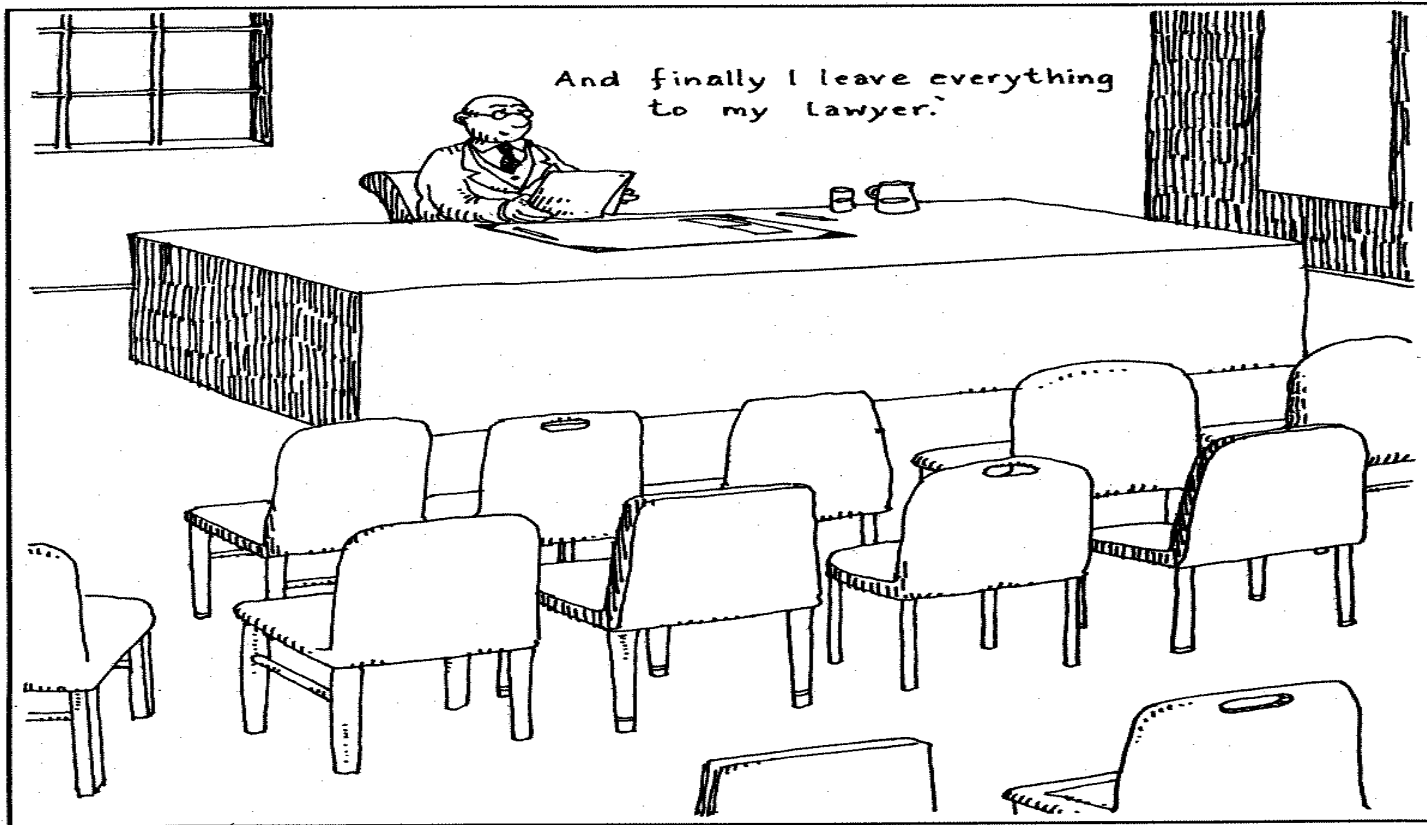




Insurance Trusts

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Insurance Trusts

A. The Strategy

- A form of testamentary trust funded with the proceeds of an insurance policy (or policies) payable on death of the testator
- For personal (not corporate) owned insurance
- Note: Similar results can be achieved for corporate owned insurance by using life insurance shares, but that is beyond the scope of this presentation
- Works on any contract governed by the *Insurance Act*, including segregated funds held in an RRSP or RRIF (but watch out for different tax treatment of these funds)
- Executor and trustee of the will or separate insurance trustees are designated as beneficiary “in trust” in the will or in a separate designation
- Terms of the trust can mirror the terms of testamentary trusts for spouse, children or other beneficiaries in the will or have separate terms (this may maximize income splitting opportunities for the beneficiaries)

Insurance Trusts (cont'd)

- If the trust is funded only from the proceeds of a life insurance policy, the terms of the trust have been established by an individual during his or her lifetime and the trust is separate from that individual's estate, CRA will treat that trust as a separate testamentary trust
- **Should the document creating the trust be a “testamentary instrument” under applicable provincial laws? If so, is placing the designation directly in the will preferable?**
- If the beneficiary is the executor and trustee (not “estate”) or separate insurance trustees, then the policy proceeds will also pass outside of probate

Insurance Trusts (cont'd)

B. Tax Implications

- If the trust is settled by the insurance proceeds on death and no one else has, or will, contribute property to the trust, the insurance trust will be a testamentary trust and have access to the graduated tax rates thereafter
- Insurance proceeds will be received on a tax free basis by the trust
- Trust will be subject to the 21 year rule from the date of death unless payable to a spouse trust in the will
- If terms are the same as other residual trusts they will all be taxed together under ss. 104(2) of the *Income Tax Act* (“ITA”) (but note technically would remain separate trusts unless trustees have the power to combine them together after initial formation)

Insurance Trusts (cont'd)

C. Compliance Issues

- Policy also retains its creditor exempt status under the applicable *Insurance Act* provided the beneficiaries of the trust are from the prescribed class of family members (spouse or common-law partner, child, grandchild or parent)



Insurance Trusts (cont'd)

D. Pros and Cons

- Useful in many situations:
 - Spouses who would otherwise name each other as direct beneficiaries of existing policies – an insurance trust creates income splitting opportunities for the surviving spouse that would not otherwise exist
 - Testators with adult children who may also benefit from income splitting
 - Testators with minor children who need testamentary trusts for estate planning purposes more than tax purposes

Selected Tax and Compliance Issues

- **1** - should the document creating the trust be a “testamentary instrument” under applicable provincial laws?
- **2** - if so, is placing the designation directly in the will preferable?
- See ss. 108(1) of the ITA re definition of “testamentary trust” – trust “arose on and as a consequence of the death of an individual”



Selected Tax and Compliance Issues (Cont'd)

- **3** – Joint last to die policies – does this work?
- Yes, can create an insurance trust on the second death
- What if the funds are required to pay debts on those owing on that second death?
- Can include provisions in the will or designation creating the insurance trust allowing the trustees to pay debts or taxes of the insured/deceased
- Can also direct that part of the proceeds be paid to the trustees of an Alter Ego or Joint Partner Trust or the estate of the first deceased joint insured for purposes of paying debts or taxes before using the balance of the death benefit to establish the testamentary insurance trust



Selected Tax and Compliance Issues (Cont'd)

- 4 – What about multiple trusts out of one policy?
- Yes, it can be done, but be careful of ss.104(2) which would aggregate all trusts together for tax purposes if there is cross-pollination of beneficiaries



Selected Tax and Compliance Issues (Cont'd)

- **5** – What do you tell the insurance company?
- 3 options:
- (1) Nothing – deal with it at end on basis of last in time designation trumps
- (2) Advise only – say changed it but not give details
- (3) Full disclosure – provide a copy of the will or new designation as it will have to be provided at time of death anyway!



Selected Tax and Compliance Issues (Cont'd)

- **6** – Is it really outside of probate if goes to executors in trust?
- Doubt arose after the Saskatchewan decision of *Carlisle Estate (Re)*, (2007) SKQB 435
- But no similar cases since and not really followed
- Plus Nova Scotia has section 84A of the *Probate Act* which provides as follows:
 - 84A Insurance money, as defined in the Insurance Act, that is, under Section 198 of that Act, not part of the estate of a deceased person by reason of a designation within the meaning of that Section made by the deceased person is not, for the purpose of Sections 85, 86 and 87 part of the assets of the deceased person or the deceased person's estate and shall not be included in the value of the estate of the deceased person for the purpose of calculating the tax payable to the registrar under those Sections. 2001, c. 5, s. 26.



Selected Tax and Compliance Issues (Cont'd)

- In other provinces may need to more clearly have:
 - Separate trustees
 - Clearly identified beneficiaries (not just as per residue)
 - Different trust terms (consider ss. 104(2) anyway)



Insurance Trustees – If separate from Executors/Trustees

- I appoint ● and ● as trustees of the separate insurance trust established pursuant to clause ● below (my “insurance trustees”)



Insurance Trust – All Policies

- I revoke all my previous designations of beneficiaries with respect to all my insurance policies and I declare that the proceeds of all my insurance policies shall be payable and paid to my [insurance] trustees as an insurance trust fund separate from my estate. They shall hold those proceeds in trust for my residual beneficiaries on the same trusts, terms and conditions as if the proceeds of these policies had formed part of the rest of my estate. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia). For greater certainty, this insurance trust will not form part of my estate and will be administered as a separate trust notwithstanding that my trustees (or one or more of them) are the trustee or trustees of this separate insurance trust.



Insurance Trust - One Policy

- I revoke any previous designation of beneficiary with respect to my insurance policy with ●, policy number ●, and I declare that the proceeds of that insurance policy shall be payable and paid to my [insurance] trustees as an insurance trust fund separate from my estate. They shall hold those proceeds in trust for my residual beneficiaries on the same trusts, terms and conditions as if the proceeds of that policy had formed part of the rest of my estate. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia). For greater certainty, this insurance trust will not form part of my estate and will be administered as a separate trust notwithstanding that my trustees (or one or more of them) are the trustee or trustees of this separate insurance trust.

Insurance Trust – All Policies – New Wording

- I revoke all my previous designations of beneficiaries with respect to all my insurance policies and I designate my [insurance] trustees as the beneficiary of all my insurance policies. The proceeds of all these policies shall be payable and paid to my [insurance] trustees as an insurance trust fund separate from my estate. They shall hold those proceeds in trust for my ●, my ● and my ● on the same trusts, terms and conditions as clauses ● below. I incorporate into this separate insurance trust by reference the terms of clauses ●. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia). For greater certainty, this insurance trust will not form part of my estate and will be administered as a separate trust notwithstanding that my trustees (or one or more of them) are the trustee or trustees of this separate insurance trust.



Insurance Trust – One Policy – New Wording

- I revoke any previous designation of beneficiaries with respect to my insurance policy with ●, policy number ●, and I designate my [insurance] trustees as the beneficiary of that insurance policy. The proceeds of that policy shall be payable and paid to my [insurance] trustees as an insurance trust fund separate from my estate. They shall hold those proceeds in trust for my ●, my ● and my ● on the same trusts, terms and conditions as clauses ● below. I incorporate into this separate insurance trust by reference the terms of clauses ●. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia). For greater certainty, this insurance trust will not form part of my estate and will be administered as a separate trust notwithstanding that my trustees (or one or more of them) are the trustee or trustees of this separate insurance trust.



Insurance Trust – All Policies – Estate Fund Type for Spouse and Children

- I revoke all my previous designations of beneficiaries with respect to all my insurance policies (including ●) and I designate my [insurance] trustees as the beneficiary of all my insurance policies. The proceeds of these policies shall be payable and paid to my [insurance] trustees as an insurance trust fund separate from my estate. They shall hold those proceeds in trust on the trusts, terms and conditions set out below. I incorporate into this separate insurance trust by reference the terms of clauses ● herein. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia). For greater certainty, this insurance trust will not form part of my estate and will be administered as a separate trust notwithstanding that my trustees (or one or more of them) are the trustee or trustees of this separate insurance trust.



Insurance Trust – All Policies – Estate Fund Type for Spouse and Children (Cont'd)

- Hold the trust property of this trust in trust for my ● and my children on terms set out below. While my ● is alive, pay the income or capital or as much of either of both as my ● may direct or, failing direction, then as my trustees think best to or for the benefit of my ● and each child. When exercising this discretion, my [insurance] trustees shall consider the care and comfort of my ● and my children as their primary concern, and not the preservation of the capital. The trustees of this trust have no duty to maintain an even hand for the benefit of subsequent beneficiaries and may fully exhaust the capital if they consider that advisable. After my ● dies, (or at my death if ● does not survive me), hold the trust property in trust on the same trusts, terms and conditions as clauses ● herein.



Insurance Trust – All Policies – Estate Fund Type for Spouse and Children (Cont'd)

- While my ● is alive, I expressly give the trustees of this trust full discretion with respect to the allocation of payments as among the beneficiaries of this trust, and with respect to the exclusion of any one or more of the beneficiaries, notwithstanding any rule of law or equity (including the rule sometimes referred to as the “even handed rule”) which may otherwise restrict the trustees’ discretion.



Insurance Designation

- I revoke all my previous designations of beneficiaries with respect to all my insurance policies and I designate my ●, ●, as the beneficiary of all my insurance policies. My ● is entitled to receive all proceeds payable under these policies on my death. This declaration shall be a declaration within the meaning of the *Insurance Act* (Nova Scotia).



Questions

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