

ALTER EGO TRUSTS AND JOINT PARTNER TRUSTS

An individual who is 65 or older and who has over \$500,000 in assets may want to consider establishing an Alter Ego Trust or a Joint Partner Trust as a convenient probate planning and succession-planning tool.

WHAT ARE THESE TRUSTS AND WHO CAN USE THEM?

Alter Ego Trusts and Joint Partner Trusts are trusts that meet specific criteria under the Income Tax Act.

An Alter Ego Trust can only be created by an individual who is 65 or older and must provide that until that individual's death:

- ❖ the individual is entitled to receive all of the income from the trust; and
- ❖ the individual is the only person who can receive or otherwise obtain the use of the income or capital of the trust.

A Joint Partner Trust must meet the same basic criteria, except that it applies to a couple. Accordingly, it must provide that while either or both parties are alive:

- ❖ the individual who creates the trust and his or her spouse or common-law partner must, together, be entitled to all of the income from the trust; and
- ❖ the individual and his or her spouse or common-law partner must also be the only persons entitled to receive or otherwise obtain the use of the income or capital of the trust.

Common-law partners, which includes same-sex couples, can use Joint Partner Trusts if they live in a conjugal relationship and:

- ❖ have lived in the conjugal relationship for a continuous period of 12 months or more, or
- ❖ are both parents of one or more children.

For the purposes of this Reference Guide, all references to spouse apply equally to common-law partners.

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HOW DO ALTER EGO TRUSTS AND JOINT PARTNER TRUSTS WORK?

Alter Ego Trusts and Joint Partner Trusts allow an individual (and his or her spouse, in the case of a Joint Partner Trust) to:

- ❖ Transfer property to the trust without tax consequences. This is because there is a deferral of tax on unrealized capital gains when assets are transferred to the trust.
- ❖ Enjoy the income from the trust during the individual's lifetime (and the lifetime of the spouse, if applicable).
- ❖ Enjoy the capital of the trust during the individual's lifetime (and the lifetime of the spouse, if applicable) if permitted under the terms of the trust.
- ❖ Determine who should receive the residue of the trust property after the individual's death (or the spouse's death, if applicable). An Alter Ego Trust or Joint Partner Trust may therefore be considered as an alternative to dealing with assets under a Will.
- ❖ Maintain control over the trust assets during the individual's lifetime (and the lifetime of the spouse in the case of a Joint Partner Trust). This can be accomplished by the individual, and his or her spouse, if applicable, being named as trustees of the trust. However, to avoid potential attribution problems, as described below, it would be preferable if the person who establishes the trust is not the only trustee.
- ❖ Provide asset protection against creditors during the individual's lifetime (and the lifetime of the spouse, if applicable) as the trust owns the property. The level of protection against creditors may, however, vary depending on the specific terms and conditions of the trust.
- ❖ Protect assets from the individual's own actions or decisions at a future time when the individual may not be fully capable.
- ❖ Specify who manages the assets in the trust if the individual (and/or spouse) is not able to do so (similar to a Power of Attorney). This would be achieved by naming alternate trustees of the trust and including provisions as to when they are to act.
- ❖ Keep the assets out of the individual's estate. This in turn:
 - reduces the probate fees payable by the estate on the individual's death. Depending on the province or territory, this could result in savings of up to 1.5% of the value of the assets in the trust.¹

¹ Currently, probate fees are capped at \$400 in Alberta and there are no probate fees in Quebec,

- keeps the individual's affairs private. In contrast, applications for probate or administration require full disclosure of assets; and
- provides potential protection of the assets from claims arising after death.

INCOME TAX CONSIDERATIONS

Capital Gains

As noted above, there are no taxes on unrealized capital gains when assets are transferred to an Alter Ego Trust or Joint Partner Trust. These taxes are deferred until:

- ❖ the death of the individual who created the trust in the case of an Alter Ego Trust or, in the case of a Joint Partner Trust, both the individual and his or her spouse have died; or
- ❖ the individual who transferred property to the trust becomes a non-resident, where it is reasonable to conclude that the property was transferred to the trust in anticipation of the move.

Attribution

The existing income tax rules with respect to attribution may apply in the case of a Joint Partner Trust. For example:

Spousal attribution: Any income or capital gain traceable to property (or substituted property) contributed to a Joint Partner Trust by one spouse and paid to the other spouse (e.g. the lower-income spouse) will be attributed back to the contributor spouse and taxable in his or her hands.

Reversionary trust rule: If the trust property (or substituted property) may revert to the person from whom the property was received, any income or loss or capital gain or capital loss related to the property is, during the lifetime of this person, deemed to be realized in the hands of this person rather than the trust. This may apply, for example, if the spouse who transferred property to the trust is also a capital beneficiary during his or her lifetime.

Potential attribution rules that may apply in the context of the creation of an Alter Ego Trust or Joint Partner Trust are complex and should be carefully reviewed with qualified tax advisors.

Income Tax Rates – Consider Testamentary Trusts First

so this is not a concern for residents of these provinces.

Alter Ego Trusts and Joint Partner Trusts are "*inter vivos*" or "lifetime" trusts. As a result, they are subject to income tax at the *highest* marginal rate on all income remaining in the trust. Trusts are also not allowed to claim personal tax credits such as the personal credit and the age credit. Accordingly, these trusts do not provide any income-splitting benefits. Rather, the benefits relate to other considerations, such as probate fee reduction, management of the assets, privacy and some possible protection from claims by creditors or others.

By comparison, testamentary trusts, which are typically created by Will, are taxed at the same graduated marginal rates that apply to individuals. Also, income accumulated and taxed in a testamentary trust (at the trust's marginal rates) becomes capital and can be subsequently distributed to the beneficiary without additional tax. Testamentary trusts therefore present considerable planning opportunities for reducing taxes, as testamentary trusts can save between \$4,500 to \$8,600 in taxes each year per beneficiary, depending on the province or territory.

Note, however, that the maximum benefit of a testamentary trust is achieved with up to about \$1,250,000 in cash or non-registered, income-producing assets.

Note that it is *not* possible to direct that assets in an Alter Ego Trust or Joint Partner Trust are to be used to fund testamentary trusts on the death of the creator of the trust (and his or her spouse), with the hope of being able to take advantage of the benefits offered by both forms of trusts. This is due to certain tax rules that state that a trust is not considered to be a testamentary trust if anyone other than a *deceased individual* contributes property to the trust. Since Alter Ego Trusts or Joint Partner Trusts are trusts, and not deceased individuals, contributions made by such trusts to another trust on death would mean that the new trust would not be considered a testamentary trust.

The use of an Alter Ego Trust or Joint Partner Trust must therefore be weighed against the potential use of a testamentary trust. In general, if a choice must be made between the probate fee savings offered by the use of an Alter Ego Trust or Joint Partner Trust or having assets held in a testamentary trust after your death, establishing the testamentary trust would generally be preferable, as it may provide ongoing tax savings to your beneficiaries.

CREATING AN ALTER EGO TRUST OR JOINT PARTNER TRUST PURSUANT TO A POWER OF ATTORNEY

Most commonly, an individual would establish an Alter Ego Trust for his or her own benefit or, if applicable, a Joint Partner Trust for the benefit of both the individual and his or her spouse or common-law partner. If an individual loses mental capacity before establishing an Alter Ego Trust or Joint Partner Trust, it may be possible for the person(s) named as his or her attorney(s) under a Power of Attorney to establish an Alter Ego Trust or Joint Partner Trust if permitted

under the Power of Attorney, in order to save probate fees on the ultimate estate. However, professional legal advice should be obtained to ensure that the Power of Attorney document provides the necessary authority to do this.

Note that based on an Ontario court decision, it may be necessary for an Alter Ego Trust or Joint Partner Trust established by an attorney under a Power of Attorney to be set up so that it does not alter how the individual's estate would have been distributed on death if the trust had not been created. This means that the trust should specify that on the individual's death (or, in the case of a Joint Partner Trust, once both the individual and his or her spouse or common-law partner have died), the assets are to go to the same beneficiaries who would have received them under the individual's Will or under the laws of intestacy (if there was no valid Will at the time of death).

ALTERNATIVE TO POWERS OF ATTORNEY

An Alter Ego Trust or Joint Partner Trust can also be used, to some extent, as an alternative to a Power of Attorney, at least with respect to your assets transferred into the trust.

Rather than appointing individuals as attorneys under a Power of Attorney, the individuals could be named as co-trustees or alternate trustees under an Alter Ego Trust or Joint Partner Trust, to take over the administration of assets as and when necessary. The property held in the trust would then be administered, during your incapacity, in accordance with the instructions provided to your trustees in the trust deed.

It should be noted, however, that an Alter Ego Trust or Joint Partner Trust would generally not fully replace the need for a Power of Attorney. For example, a Power of Attorney would still be needed to deal with any property or assets not held in the Alter Ego Trust or Joint Partner Trust. There are also numerous other possible situations that only a Power of Attorney could properly address.

OTHER CONSIDERATIONS

Other important issues to consider when contemplating an Alter Ego Trust or Joint Partner Trust include the following:

- ❖ A Will is always revocable and may be updated at your discretion at any time when your family circumstances or testamentary wishes change. An Alter Ego Trust or Joint Partner Trust may not be amended at your discretion, so such trusts do not offer the same flexibility if your succession objectives change over time.
- ❖ On death, assets held in an Alter Ego Trust may not be transferred on a tax-deferred basis to the surviving spouse. Furthermore, as indicated above, tax



planning opportunities that may arise through the use of testamentary trusts created by Will are lost with respect to assets held in an Alter Ego Trust or a Joint Partner Trust.

- ❖ There are implementation costs as well as ongoing costs related to the creation and continuation of an Alter Ego Trust or Joint Partner Trust. Such costs should be assessed with your professional advisors prior to implementing such a strategy.

CONCLUSION

An Alter Ego Trust or Joint Partner Trust could, in appropriate circumstances, be considered as an alternative to dealing with assets under a Will, to implement testamentary intentions and reduce probate fees, while enabling you to enjoy the benefits of ownership. However, the advantages and disadvantages related to the use of a Alter Ego Trust or Joint Partner Trust must be carefully weighed in light of your specific circumstances, needs and objectives.