ALTER EGO AND JOINT PARTNER TRUSTS

Trusts have long been used as a method of maintaining control of assets while keeping them out of the estate on which tax is payable. Creating a trust with assets that have appreciated, however, usually results in a large capital gain, and a consequently large tax bill. Alter Ego and Joint Partner Trusts are special trusts for those over the age of 65 to move assets into a trust without triggering capital gains.

The Legislation

Anyone over 65, who is resident in Canada, can transfer assets into a Canadian-resident trust without triggering capital gains. As long as all of the income of the trust, known as an Alter Ego Trust, is payable to the person who settled the trust (the settlor), and no capital is paid to anyone but the settlor, there will be no tax on capital gains until the settlor dies. A similar arrangement, referred to as a Joint Partner Trust, is available to a couple where one of them is over the age of 65, and all of the income is paid or payable to the couple or the survivor of them, and no capital is paid to anyone else.

Probate

Probate is judicial evidence of the authority of the executors to deal with an estate. When an application is made for probate, Ontario levies an Estate Administration Tax (EAT) on the value of the assets that pass under the will. The rate of tax is 1.5% of the probatable estate. Some assets are not included in this calculation such as assets held in joint tenancy, life insurance and registered plans, and real estate outside of Ontario. Assets held in a trust are also not included in the estate on which estate administration tax is levied. Trusts are therefore an excellent way to avoid paying EAT.

Trusts

A trust is a relationship between one person (the trustee) who holds property, but for the benefit of someone else (the beneficiary). A trust can have more than one trustee, and more than one beneficiary, including minors, and even unborn children. The trust deed sets out the rules governing how the trust assets are managed, and the trustee is bound by law to act in the best interests of the beneficiary. A trust will pay income tax on any income (including capital gains) that is not paid or payable to beneficiaries.

Generally, a transfer to a trust is considered a disposition, and the transfer of an appreciated asset to a trust produces a taxable capital gain. Spousal, Alter Ego, and Joint Partner Trusts are an exception to this rule. Assets may be put in these trusts without triggering capital gains. A principal residence can be transferred to an Alter Ego or Joint Partner trust without losing its tax exempt status.

Benefits of a Trust

A trust is an established way to reduce the estate on which probate tax will be levied. In addition, because of its flexibility, a trust is an excellent way to plan for the uncertainties of later life. A trust can be set up now to facilitate a seamless transfer of control from the owner to his or her chosen delegate on incapacity and on death, and the trust has the flexibility to meet the changing exigencies of old age. When the trust is wound up, you can dispose of the estate in much the same way as a will. The trust document does not need to be made public through probate, as a will may.

Some Disadvantages

Trusts require reliable, competent and active trustees, since they will have knowledge of and control over all the assets placed in the trust. If beneficiaries are high income earners, and could benefit from the reduction in income tax rates that is possible if assets are held personally and pass by will into a testamentary trust, an Alter Ego or Joint Partner Trust may not be advisable. A trust will also entail some additional expense and work to transfer assets and to file T3 Trust returns each year.

Recommendation

Estate planning through trusts should be considered. Not only does a trust save on probate taxes, but it can provide a seamless and private transition from full control of assets through incapacity and death. Alter Ego and Joint Partner Trusts should only be prepared with legal advice to determine which assets should be settled in the trust and to ensure that the trust deed is properly drafted. The relative tax advantages of a trust set up in a will, as opposed to during your lifetime, also need to be considered.

Cunningham Swan offers a broad range of legal services to individual and corporate clients in the private and public sectors in Kingston and Southeastern Ontario. We welcome your inquiry: Cunningham Swan Carty Little & Bonham LLP, Suite 300, Smith Robinson Building, 27 Princess Street, Kingston, ON, K7L 1A3; Telephone: 613.544.0211; Facsimile: 613.542.9814; Email: info@cswan.com. This factsheet does not constitute legal advice.