



LAFRENIÈRE SANNA
— ESTATE LAW —
A B O U T I Q U E F I R M

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Alter Ego and Joint Partner Trusts

Amendments to the Income Tax Act have resulted in certain types of inter vivos trusts, namely alter ego trusts and joint partner trusts, becoming more popular estate planning tools. For tax purposes, a trust is considered to be inter vivos (between the living) when the person creating or settling the trust, the “settlor”, is alive. It is to be distinguished from a testamentary trust which is created by an individual’s Will and arises on, and as a consequence of, that individual’s death.

An alter ego or joint partner trust must meet the requirements set out in the Income Tax Act:

- at the time of the trust’s creation, the settlor is a taxpayer at least 65 years of age;
- the trust was settled after 1999;
- both the settlor and the trust must be resident in Canada (generally, this means that the trustee must be a resident of Canada for tax purposes;
- the settlor, or the settlor and his or her spouse for a joint partner trust, must be entitled to receive all the income of the trust that arises before the settlor’s death or the death of the second spouse;
- no one other than the settlor, or the settlor and his or her spouse for a joint partner trust, can, before the death of the second spouse, receive or otherwise obtain the use of, any of the income or capital of the trust.

Generally, an alter ego or joint partner trust will not be settled where the sole purpose of its creation is to reduce income taxes as a number of tax considerations arise in relation to such trusts.

Unlike property transferred to a general inter vivos trust, property transferred to an alter ego or joint partner trust can be transferred on a tax-deferred basis thus avoiding the immediate

realisation of capital gains or losses for tax purposes. The trust will be considered to have acquired the property at a cost equal to the Settlor’s cost immediately before the transfer. This is referred to as a ‘rollover’. It is important to note that a trust is entitled to elect out of the rollover for some or all of the property transferred to it.

Once an alter ego trust is established, any trust income will be taxed in the settlor’s hands. For joint partner trusts, any income will be taxed in the settlor’s hands; however, income from property contributed by one spouse will be taxed in that spouse’s hands. Upon the death of the settlor, for a joint partner trust, the income paid to the spouse is taxed in his or her hands or an election can be made to tax the income in the trust.

The attribution rules in the Income Tax Act will apply where the settlor retains an interest in the capital of the alter ego or joint partner trust or where the settlor retains the power to distribute capital or determine beneficiaries. This results in any income, losses, capital gains and capital losses attributing back to the settlor. Where this is not the case, any capital gains are taxable in the trust.

The 21-year deemed disposition rule in the Income Tax Act does not begin to apply until the death of the settlor or the death of the last to die of the settlor and the settlor’s spouse for a joint partner trust. Again, the trust is entitled to elect out of this rule.

On the date of the settlor’s death or on the date of the last to die of the settlor and the settlor’s spouse for a joint partner trust, the trust will be deemed to have disposed of all of its property for proceeds equal to the fair market value on that date and to have acquired that property at a cost equal to such proceeds. As a result of this deemed disposition, any gains or losses are taxable to the

trust, and not to the individual's estate, and taxed at the highest marginal rate at that time. Similarly, capital losses cannot be transferred from the trust to the individual's estate to offset any gains.

Despite the potentially negative tax consequences discussed above, there are advantages to the creation of an alter ego or joint partner trust.

One of the key advantages of an alter ego or joint partner trust is that the distribution of property on death will not trigger probate tax as the property is distributed under the terms of the trust and not through the individual's Will. In some circumstances, the avoidance of probate tax alone may be enough incentive to use such a trust. In addition, the distribution of the property and its value does not become a matter of public record and any delay caused by the probate process will be avoided.

An alter ego or joint partner trust can ensure that the trust property is immediately distributable to the beneficiaries upon the settlor's death, or the death of the settlor's spouse for joint partner trusts, subject to any income tax filing that may be necessary. In Ontario, there is no requirement to probate assets held by such a trust.

In some circumstances, an alter ego or joint partner trust may offer some protection against certain types of creditors upon the settlor's death.

If an individual is facing the possibility of deteriorating mental or physical health, an alter ego or joint partner trust can ensure that assets and financial affairs will be managed during any subsequent incapacity as long as the individual is not a sole trustee with no provision for the appointment of an alternate trustee(s).

If charitable giving is a planned objective, an alter ego or joint partner trust can allow an individual to benefit from donation tax credits where the individual, and his or her spouse in the case of a joint partner trust, will have no access to the capital of the trust over the course of his or her lifetime and one or more charities is named as the ultimate beneficiary of the trust.

In summary, the advantages of an alter ego or joint partner trust must be weighed against the disadvantages which include:

- the costs of setting and administering the trust including legal fees, trustee fees, preparation of trust tax returns, and the

duty to account, all of which result in increased cost and added complexities;

- the possible loss of control over the property once it is transferred to the trust;
- the potential loss of capital gains exemption unless the alter ego trust allows for a three-year waiting period before distribution to beneficiaries;
- the property in an alter ego or joint partner trust cannot be transferred to a testamentary trust. A trust that is established on death and which includes assets from an alter ego or joint partner trust will not have the benefit of graduated tax rates and will, in fact, be subject to the highest marginal tax rate rather than being subject to graduated tax rates as testamentary trusts (please see our brochure entitled "How Testamentary Trusts Can Help You and Your Family"); and,
- the less favourable tax treatment of charitable gifts made through an alter ego or joint partner trust.

In determining whether to settle an alter ego or joint partner trust, it is important to weigh the advantages of probate savings and confidentiality with the significant tax considerations and other potential disadvantages. It is necessary to review all of the potential settlor's assets and income to determine whether the probate savings will outweigh the tax implications. Similarly, any other unique circumstances must be carefully considered.

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