O'SULLIVAN
ESTATE LAWYERS

March 2023

Advisory

Alter ego and joint partner trusts

This chapter presents an overview of uses of alter ego trusts and joint partner trusts as substitutes for wills and powers of attorney in estate planning for those age 65 or older.

WHAT IS A TRUST?

A trust is a type of relationship. The key element of a trust is that title to property is transferred to a person (the "trustee") who has a legal obligation to hold the property for the benefit of others (the "beneficiaries").

A trust may be established during a settlor's lifetime (an "inter vivos" trust), or it may be established under a will, and as a result, only take effect on death in accordance with the terms provided under the will (a "testamentary" trust).

WHAT IS AN "ALTER EGO TRUST" AND A "JOINT PARTNER TRUST"?

Alter ego trusts and joint partner trusts are specific inter vivos trusts provided for under the *Income Tax Act* (Canada)(the "ITA"), to which persons age 65 or older may transfer assets on a tax-deferred basis. Normally, a transfer of property to a trust creates a taxable disposition and results in tax on any capital gains.

REQUIREMENTS TO QUALIFY AS AN ALTER EGO TRUST OR JOINT PARTNER TRUST

If a trust is to qualify as an alter ego trust or joint partner trust under the ITA, the following conditions must be met:

- the trust must have been created after 1999;
- the "settlor", i.e. the person transferring the property, must have been age 65 or older at the time the trust is created;

O'Sullivan Estate Lawyers LLP
TD Bank Tower, Toronto-Dominion Centre
66 Wellington St. W, Suite 3430, P.O. Box 68
Toronto, ON M5K 1E7

osullivanlaw.com
T 416-363-3336
F 416-363-9570

- to qualify as an alter ego trust, the settlor must be entitled to receive all of the income of the trust that arises before death, and no other person may receive or obtain the use of any of the income or capital of the trust prior to the settlor's death; and

- to qualify as a joint partner trust, the settlor and his or her spouse or common-law partner must, in combination with each other, be entitled to receive all of the income of the trust that arises before the later of the death of the settlor and his or her spouse or common-law partner, and no other person may receive or obtain the use of any of the income or capital of the trust before the later of those deaths.

HOW ARE ALTER EGO TRUSTS AND JOINT PARTNER TRUSTS TAXED?

Transfer of property to an alter ego trust or joint partner trust can occur on a tax-free basis. Alter ego trusts and joint partner trusts are taxed like other inter vivos trusts at the top marginal rate applicable to individuals. Income of an alter ego trust must be paid to the settlor and income of a joint partner trust must be paid to either or both of the settlor and his or her spouse. Tax on such income is paid by the settlor or his or her spouse at his, her or their respective graduated rates of tax unless a special tax election is made to tax the income in the trust.

There is a deemed realization of the assets of an alter ego trust on the date of death of the settlor, and for a joint partner trust, on the date of death of the survivor of the partners, and in each case every 21 years thereafter unless an election is made to trigger an earlier disposition. As a result of this deemed realization, tax is payable on any taxable capital gains.

BENEFITS OF USING AN ALTER EGO TRUST OR JOINT PARTNER TRUST

(a) Avoidance of Probate

(i) Tax Savings

While a will comes into force only upon death, a trust comes into immediate effect once established and can deal with disposition of property both during one's lifetime and upon death. Property held by a trust passes outside of one's estate, and is distributed on death in accordance with the terms of the trust agreement. Since assets held by the trust do not form part of the estate, there is no Ontario Estate Administration Tax ("OEAT") of 1½% paid on the value of assets passing under the trust, with the exception of the first $50,000 which pass tax-free. The following chart illustrates possible OEAT savings of using a trust, versus using a will under which assets will form part of one's estate and be subject to OEAT:

Size of Estate	OEAT Payable
$750,000	$ 10,500
$2 million	$ 29,250
$5 million	$ 74,250
$10 million	$ 149,250
$15 million	$ 224,250

(ii) Less Delay and Professional Fees

Delay in waiting for issue of the court order, and legal fees incurred in the probate process are eliminated, including the need to prepare a court application to probate the will and its associated costs.

(iii) Multiple Probate Proceedings Avoided

If assets, in particular real estate located in a foreign jurisdiction which recognizes the concept of a trust, is held in the name of trustees under a trust, on death there is no need to submit a will to probate in the foreign jurisdiction to deal with the property because it will not form part of one's estate. As a result, the administration of real estate is expedited, with potential significant savings, including for payment of local court and professional fees in order to secure probate in the foreign jurisdiction.

(iv) More Flexibility in Choice of Trustees if there are Foreign Assets

In will planning, the choice of executors and trustees is often restricted because of the problems which might be encountered in attempting to have one's preferred choice of executors and trustees qualify in a foreign jurisdiction. These constraints do not apply if a trust is used because there will be no need to interface with the local court process on one's death.

(b) Risk of "Lost" Assets Minimized

Establishment of a trust also forces one to "put one's house in order" prior to death, and to create and organize a comprehensive record of all assets for purposes of affecting transfer

to the trustees of the trust. The risk of "lost" or unfound assets because of incomplete information after one's death is minimized.

(c) Estate Administration Simplified and Expedited

If assets have been transferred during lifetime to a trust, the gathering in of assets and transfer of title to executors, which normally forms a significant part of the estate administration process, will have already been accomplished. In effect, the estate has been "pre-administered" and distribution can be accomplished expeditiously.

(d) Confidentiality

Another key benefit of use of a trust as a will substitute is that the trust agreement is, and remains, a private document. This is in contrast to a will submitted to probate. To secure a Certificate of Appointment of Estate Trustee or court order to probate a will, a will must be submitted to court, and once the Certificate or court order is issued, the will becomes a public document, available from the court file to anyone who wishes to secure a copy and review its terms. In addition, all of the court documents submitted in support of the application for a Certificate are also available for public scrutiny, which in Ontario includes the value of one's estate. To ensure continued privacy of one's affairs after death, a trust should be considered.

(e) Protection Against Estate Litigation

A trust allows for continuity in the holding of title to assets and their management on death. The trustees are already appointed, and the trust property is under the control of the trustees. They are in a position to proceed with distribution of the assets, subject to payment of taxes and other debts and expenses of the trust, and to carry out its terms. There is no change in control on death which occurs when executors or estate trustees are appointed under a will, who must first establish to third parties their authority to deal with the assets of the estate by submitting the will to court to obtain probate, at which point its validity may be challenged by disgruntled family members and others.

If a trust has been in existence and under the trustees' administration for many years prior to death, challenges based on lack of testamentary capacity, undue influence and suspicious circumstances may be more difficult to sustain from an evidentiary standpoint than when a will is used.

(f) Continuity of Management

Because a trust agreement does not need to be validated by a formal probate proceeding, a trust provides for greater continuity in the management and administration of one's assets after death. In contrast, until a Certificate of Appointment of Estate Trustee is obtained to

establish an executor's authority to third parties, most assets are virtually frozen. Continuity, and a smooth transition on death, can be very advantageous, particularly in estates which hold complicated assets, such as an active business where minimal disruption to the business will be critical.

(g) Liquidity

An immediate need for liquid assets on death can be met where a trust is used. If a will is used, during the time period awaiting probate, assets may be frozen and there may be few or no liquid assets available to provide for the support of a surviving spouse or other family members, or to meet immediate cash needs. A trust avoids such hardship.

(h) Planning for Incapacity: Trust vs. Power of Attorney

A trust offers several benefits which are superior to use of a Continuing Power of Attorney for Property for managing assets in the event of incapacity.

(i) A Trust Agreement is More Comprehensive

Using a trust agreement, one may choose individuals to act in the event of one's incapacity who are subject to comprehensive terms providing for the trustees' specific duties and powers, tailored to meet one's individual circumstances. In contrast, powers of attorney are typically simple documents which do not contain sophisticated provisions dealing with such matters as the appointment and replacement of attorneys, or detailed provisions providing a framework for the management of property, including for example, business assets or real estate.

(ii) Trusts Continue After Death: More Continuity

While a trust continues on after death, a power of attorney does not. Uninterrupted management by the trustees can continue after death or incapacity without the need to wait until estate trustees have probated a will to establish their authority to third parties.

(iii) Better Protection in the Event of Incapacity

A trust arguably offers superior protection to a power of attorney in the event of one's financial incapacity. The property held under the trust can be managed by one's trustees, and the ability to continue to independently deal with assets, once incapacity has been determined, can be terminated in accordance with the procedure stipulated under the trust agreement, usually by medical opinions.

In a situation where there is a potential for undue influence and "overreaching" by friends and relatives, a trust arrangement is more protective than a power of attorney. Because one will not have independent control of one's assets, and the involvement of one's trustees will be necessary, a wall of protection is created. In contrast, under a power of attorney, the donor can act unilaterally. How "protective" the trust will be depends on how its terms have been structured, including whether one has reserved a power to remove the trustees or to revoke the trust arrangement.

(iv) Greater Privacy and Control

A trust arrangement is highly private. Its use results in less involvement of the courts or government regulatory bodies such as the Public Guardian and Trustee than if a power of attorney is used. A power of attorney will terminate if a court application is brought for appointment of a guardian. As a result, it cannot be relied on to secure one's choice of who should manage one's affairs in the event of incapacity since this issue may always become subject to court determination. If one's assets are settled on trust, they will not be subject to such intervention – instead, only assets one directly retains will be. Accordingly, a trust can be more effective in ensuring continued private and confidential control and management of one's affairs, without the intervention of outside regulatory government bodies or the courts.

(v) Comprehensive Management of Assets in Multiple Jurisdictions

If one dies owning assets located in several jurisdictions, in particular real estate, complex estate administration issues often rise. If one becomes incapable and owns assets in several jurisdictions, it is even more problematic.

Failing the existence of powers of attorney prepared in each jurisdiction in local form which survive incapacity, the prospect would then arise of having to commence court proceedings in each jurisdiction for a guardian, committee or equivalent legal representative to be appointed, an extremely expensive and time-consuming process. In addition, local rules may prescribe that only a resident of the jurisdiction may be appointed by the court.

The use of a trust will circumvent the need for multiple powers of attorney, as well as the problems encountered if local law does not allow for continuing or durable powers of attorney which survive a donor's incapacity.

CONCLUSION

Use of an alter ego trust or joint partner trust should be considered in estate planning for those who are 65 or older who can benefit from the tax-deferral they offer on establishment

of the trust and transfer of assets to it. Relevant tax considerations should be taken into account with regard to their suitability.

The cost of establishing the trust, including professional fees to plan and prepare the trust agreement and arrange for transfer of title to the trustees, must also be factored in, as well as ongoing costs such as possible trustee fees. One's comfort level with managing assets with one or more co-trustees is another important factor.

Each individual situation will be different in terms of whether or not an alter ego trust or joint partner trust is a suitable choice to achieve one's objectives. For many, they offer a substantial array of benefits which make them an increasingly common and important estate planning tool.