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Alter Ego and Joint Spousal/Partner Trusts
The Trust and Tax Issues

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I. Introduction

- Use of trusts as a will substitute
  - Avoids probate, probate fees and potential *Wills Variation Act* claims
- Transfer of assets to a trust generally triggers a disposition and any capital gains must be reported and taxed

I. Introduction (Cont'd.)

- Can be a disincentive
- Non-appreciating capital property can be transferred without income tax consequence
  - Principal residence trust
    - Property transfer tax may be a concern
  - Trust for cash assets
  - Insurance trust

I. Introduction (Cont’d.)

- Transfers to alter ego and joint spousal/partner trusts can be made on a tax-deferred basis

II. Characteristics

- Created during settlor’s lifetime after 1999
- Settlor 65 or older
- Settlor and trust reside in Canada
- Settlor (or with a joint spousal/partner trust, settlor and settlor’s spouse/partner, in combination with each other) entitled to all income during lifetime

II. Characteristics (Cont'd.)

- No person other than settlor (or settlor and/or spouse/partner) entitled to receive or otherwise obtain use of trust capital
- On death of settlor (or with a joint spousal/partner trust, death of survivor of settlor and settlor's spouse/partner);
  - Trust wound up and assets distributed – can be the same as existing will provisions; or
  - Ongoing trust provisions established for beneficiaries

III. Advantages

- WVA protection
- Saving of probate fees and possibly legal costs and delay related to probate
- Incapacity planning
- Privacy
- Orderly administration
- Creditor protection
- Vehicle for charitable giving

IV. Disadvantages

- Loss of control
- Cost
- Complexity
- Loss of graduated tax rates (available to testamentary trusts)
- Difficulty in amendment
- Other disadvantages

V. Transfer of property to trust

- Generally:
  - All assets must be formally transferred
- Principal Residence:
  - Property transfer tax
    - S. 14(3)(b)
    - "related individual"
  - A transferor is not related to him or herself
    - *Fuller v Her Majesty the Queen*

V. Transfer of property to trust (Cont'd.)

- Principal Residence:
  - What if the "related individual" is a trustee?
    - Policy – trust ignored for purposes of exemption
    - Reassessment risk?
  - One solution:
    - Trustee is "related individual" (exemption code 5)
    - Change of trustee (exemption code 26)
    - Trustee either sells or transfers to beneficiary (exemption code 41)

VI. Taxation

- Main tax advantage – on the transfer to the trust, there is an automatic rollover under ss. 73(1) of the *Income Tax Act*
  - Capital property transferred at its cost base or undepreciated capital cost
  - Unless settlor elects out of ss. 73(1) for the particular property – then fully taxable based on fair market value proceeds of disposition

VI. Taxation (Cont'd.)

- Deemed disposition occurs at same time as if no trust created
  - Alter ego trust – death of settlor
  - Joint spousal/partner trust – death of survivor of settlor and spouse/partner
  - Disposition of trust property at fair market value at end of day

VI. Taxation (Cont’d.)

- Trust reacquires property day after death at fair market value
- Trust’s cost base “bumped” where there is accrued gain
- Any capital loss is trapped in the trust and can’t be allocated to beneficiaries

VI. Taxation (Cont'd.)

- Capital gain on deemed disposition at death taxable to trust – no ability to allocate to beneficiaries
- 21-year rule
  - Does not apply to first transfer to trust by settlor
  - Applies after death of settlor (or settlor and spouse/partner) if trust continues to exist after relevant death

VI. Taxation (Cont'd.)

- During lifetime of settlor or spouse/partner, income, capital gains or losses – attributed to settlor under ss. 75(2)
- Ss. 75(2) attribution can be avoided:
  - If settlor has no control
  - If settlor has no entitlement to capital

VI. Taxation (Cont'd.)

- During lifetime of settlor, income, capital gains or losses paid or payable to:
  - spouse/partner under joint spousal/partner trust attributed to settlor
  - Settlor are taxed in the settlor's hands

VI. Taxation (Cont'd.)

- Ss. 104(13.1) and (13.2) allow the income paid or payable to the settlor or the spouse/partner to be taxed in the trust assuming ss. 75(2) not applicable
  - Useful for obtaining lower provincial tax rate. Alberta = 39%; B.C. = 43.7%
  - Useful to absorb losses of the trust

VII. Conclusion

- Alter ego and joint spousal/partner trusts are useful vehicles assuming the advantages outweigh the disadvantages for the client