



Alter Ego and Joint Partner Trusts Effective Substitutes for Estate & Will Planning

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Traditionally, individuals have used a Will to distribute assets they own at the time of their death. However, a number of issues can arise when assets pass under a Will in British Columbia. The three most common issues encountered are:

- 1) *Under current provincial legislation, various classes of dependants can ask the court to rewrite the Will if a dependant is not satisfied with the Will's provisions.* This legislation allows a surviving spouse and surviving children to challenge the Will. In essence, the court is asked to judge whether the deceased individual fulfilled his or her moral obligation to the person in question (independent of need). Many clients are concerned about this type of litigation potentially tearing the family apart after their death.
- 2) *Impact of probate fee costs on asset value.* This cost is currently 1.4 percent of the gross estate value where the total estate value exceeds \$50,000
- 3) *Probating a Will is a public process.* Current legislation requires that the probate application list all the assets of the deceased and the total value of those assets. Maintenance of privacy may be exposed if probating an estate is required as these probate documents are publically accessible.

In planning to avoid these potential problems, many estate planners have been using Will substitutes in order to transfer family assets. One very popular type of structure used has been an inter vivos trust, which is a trust created during a persons lifetime. It has always been possible to use an inter vivos trust as a Will substitute. However, the gifting of assets to a non-spousal trust that names other persons as beneficiaries usually results in a disposition of those assets at fair market value for income tax purposes. This can result in the payment of significant income tax at the time of the transfer.





Alternative Tax Structures for Inter Vivos Trusts

In order to provide specific relief from the potential capital gains arising on the transfer of assets to an inter vivos trust, tax legislation was amended to introduce the concepts of an “alter ego trust” and a “joint partner trust”.

A gift of assets to an alter ego or a joint partner trust will qualify for a tax deferred rollover treatment, thereby avoiding the triggering of tax on accrued gains. However, in order for this tax deferred rollover treatment to apply, these trusts must meet certain criteria as follows:

- (1) the person creating the trust has attained 65 years of age,
- (2) the trust was created after 1999,
- (3) the person or their spouse are the only one's entitled to receive all of the income of the trust, and
- (4) no person or their spouse (last to die) is entitled to receive or obtain the use of any of the income or capital of the trust.

Like a traditional spousal trust, the alter ego and the joint partner trusts contemplate contingent beneficiaries who will receive the income and capital of the trust after the death of the individual or the surviving spouse (as the case may be). The assets in the trust then effectively bypass probate, provided that the trust qualified as a true inter vivos trust. It is important to obtain clear legal advice with respect to the drafting of the alter ego or joint spousal trust documents. In some provinces, an inter vivos trust can become subject to Wills variation legislation as a result of powers held by the deceased just before death.

It is important to understand that the use of an alter ego trust or joint partner trust does not avoid the deemed disposition of assets on death. The deemed disposition occurs at the same time as it would have occurred if the trust had not been established. For income tax purposes, the deemed dispositions will be realized and reported on the final income tax returns of the original settlor in the case of an alter-ego trust and the last surviving spouse in the case of a joint partner trust.





Generally, inter vivos trusts are subject to the 21 year deemed disposition rules causing potential gains to be realized for tax purposes every 21 years. However, for alter ego and joint partner trusts, the starting date for this 21-year deemed disposition rule is delayed and only commences from the date of death of the settlor or surviving spouse. As a result, these trusts will not need to deal with deemed dispositions during the lifetime of the individual or the spouse.

Potential Planning Opportunities

The alter-ego and joint partner trusts have become significant estate planning tools for individuals wishing to avoid probate fees and potential Wills variation actions. The use of these trusts provides planning opportunities for effective tax structuring for estates. Further opportunities are also available to effectively utilize an alter ego trust as a substitute for an *enduring power of attorney* – that is, where your attorney can make financial and legal decisions for you if you are mentally incapable due to accident or illness..

Here's a summary of planning opportunities available for an alter ego or joint partner trust structure:

1) **Probate fee relief**

Can effectively structure an individual's estate to escape the B.C. probate fee cost of 1.4 percent on the total market value of the deceased's assets on death. For an estate with a value of \$5.0 million the potential probate fee savings would amount to \$70,000.

2) **Alternative Wills planning**

Allows for specific distribution of an individual's estate assets without being potentially legislated and bound under the rules applicable to Wills. (ie. the potential to avoid Wills variation action). This could allow for the distribution of assets as one sees fit without future potential court intervention. Also avoids public disclosure of an individual's estate as these trusts are not subject to public disclosure.

3) **Alternative Power of Attorney planning**

Alter ego trusts may become a valuable tool as a substitute for *powers of attorney* under certain circumstances as follows:

- Flexibility of the trust allows customization to meet the disability planning needs of clients, especially where the needs are unique and not otherwise adequately provided for in an enduring power of attorney.
- Customization of the trust arrangement focuses on the specific needs of the client, thereby creating a clear focused approach to development of structured plans to deal with matters currently encompassed under powers of attorney.





- Allows for specific appointment of alternate trustees in the event of the settlor's incapacity.
- Significant flexibility in the drafting of the trust arrangement can assist in areas dealing with matters such as: extensive directions regarding future health care issues and decisions thereon; directions regarding charitable giving following the settlors incapacity; and directions on loans to be made to family and friends following the settlors incapacity.
- Greater ease in dealing with future business transactions as the Power of Attorney is only effective to the extent the third party can be persuaded to deal with the attorney on behalf of the donor. Where the Power of Attorney contains restrictions and/or unusual features, third parties will require more extensive supporting documentation and may be hesitant to act thereon if the document is somewhat different than what they are accustomed to.
- Dealing with matters outside the local jurisdiction in which the Power of Attorney was created may be more difficult. For example, in North America alone, each province and state has different statutes and duties of attorneys which will require different types of documents and procedures to be taken to transact the affairs of the client. Trust agreements and the authority of a trustee acting on behalf of a trust are generally well understood and recognized.

Conclusion

Significant planning opportunities may be available to you when structuring your estate planning using alter ego and joint partner trusts. These trusts could allow you to more effectively manage your affairs, in addition to providing cash flow savings to your estate where probate fees can be avoided. Use of these trusts may also allow you to plan your estate distribution with a greater degree of certainty that is not subject to intervention by the courts under Wills variation legislation.

Given the potential income tax and legal complexities regarding these trust deeds, we recommend you seek professional advice before you consider establishing an alter ego or joint partner trust.

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