

The Navigator



Wealth
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RBC Wealth Management Services



The Serber Team
RBC Dominion Securities

David Serber

Vice President, Portfolio Manager and
Wealth Advisor
david.serber@rbc.com
416-974-3530

Rosetta Perrino

Associate
rosetta.perrino@rbc.com
416-974-1726

2345 Yonge Street, Suite #1000
Toronto, Ontario, M4P 2E5

www.davidserber.com
1-800-766-1034

Alter ego and joint partner trusts

An estate planning strategy to protect your wealth

You've taken a lifetime to accumulate your wealth. You want to ensure that your estate is well protected and that your assets are managed according to your wishes, both during your lifetime and beyond. An Alter Ego or Joint Spousal or Common-Law Partner Trust ("Joint Partner Trust") can help you do just that by minimizing probate tax, protecting your capital from potential undue influence and giving you the peace of mind that your finances are being properly managed. The purpose of this article is to provide you with some basic information on alter ego and joint partner trusts, discuss some of their benefits and drawbacks and outline some scenarios where it may be beneficial to use trusts of this kind.

For the purposes of this article, we have assumed you are not a U.S. person (U.S. citizen, green-card holder or resident). If you are a U.S. person, you should consult a qualified cross-border tax professional before you establish these kinds of trusts.

This article may outline strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax and/or legal advisor before acting on any of the information in this article.

Assets transferred to an alter ego or joint partner trust do not form part of the estate and therefore are not included in the calculation of probate tax.

What are alter ego and joint partner trusts?

An alter ego trust is an inter vivos trust created after 1999 by someone (the settlor) who is 65 years of age or older at the time they create the trust. The settlor must be entitled to receive the income of the trust while alive and no other person other than the settlor can receive or use income or capital from the trust during the settlor's lifetime.

If the settlor is 65 years old and wishes to include their spouse or common-law partner as a beneficiary of the trust, they can use a joint partner trust. For the purposes of this article, any reference to "spouse" includes a common-law partner. A joint partner trust differs from an alter ego trust in one respect. Under the terms of this trust, the settlor in combination with their spouse must be entitled to receive all income from the trust prior to the death of the second spouse. No-one else can receive or use any income or capital from the trust before the death of the second spouse.

To create an alter ego or a joint partner trust, the settlor and the trust must be resident in Canada at the time the assets are transferred to the trust.

Since 2016, testamentary trusts generally no longer benefit from graduated tax rates. Graduated tax rates have been replaced with flat top-rate taxation that's currently used for most inter vivos trusts (i.e. taxed at the top personal marginal tax rate) making them less attractive from a tax perspective. In the absence of the favourable taxation that was previously available to testamentary trusts, estate planners may now wish to reconsider the benefits that inter vivos trusts, including alter ego and

joint partner trusts, can provide as part of an estate plan.

Advantages of alter ego or joint partner trusts

Alter ego or joint partner trusts may provide the following benefits (note many of the advantages and benefits set out below do not apply in the province of Quebec):

1) Reduction of probate tax

Probate is the judicial process whereby the courts confirm an executor's authority to deal with the assets of an estate. Probate tax is usually payable as part of this process. The amount of probate tax is usually calculated as a percentage of the value of the assets that form part of the estate. Assets transferred to an alter ego or joint partner trust do not form part of the estate and therefore are not included in the calculation of probate tax.

2) Continuous management of property

If your executor is required to probate your Will, they may not be able to administer your estate until probate is granted. This may take some time. In addition, if you own assets, such as real estate, in different provinces or countries, your executor may be required to probate your Will in more than one jurisdiction. This can be both time consuming and costly. By transferring your property to an alter ego trust or joint partner trust, you may be able to minimize the disruption to the management of your assets since the trustees of your alter ego or joint partner trust will not need to obtain probate in order to administer the trust assets.

3) Privacy and confidentiality

If your Will is probated, it becomes a



A trust may also be a more effective way to manage assets than a power of attorney in cases of diminished capacity.

public document. Anyone can obtain a copy of your probated Will from the court. This may disclose both your testamentary intentions and the value of your estate. If you wish to keep this information private, you may want to consider transferring your assets to an alter ego or joint partner trust. The trust document that governs the administration of the trust is private and will not be subject to public scrutiny.

4) Protection from estate litigation

It may be more difficult to challenge the validity of a trust than a Will. In addition, a number of Canadian jurisdictions have laws enabling dependents to challenge the adequacy of the support provisions made for them in a Will. If you want to ensure that your estate is distributed in accordance with your wishes, you may want to consider using an irrevocable trust. Note that a court may be able to set aside a transfer to a trust or rule that trust assets form part of the estate in certain extreme situations. For example, this may occur in cases involving a spouse or minor child.

5) Alternative to a power of attorney

A power of attorney allows the person you appoint as your attorney to assist you in managing your assets. If you transfer your assets to an alter ego trust, you could choose to appoint the same person as trustee to manage the trust assets. In certain situations, there can be advantages to using a trust instead of a power of attorney when you are planning for incapacity. For example, if you have assets in multiple jurisdictions, you may need multiple powers of attorney to meet the different legal requirements of those jurisdictions. If your assets are managed in a

trust, foreign banks and financial institutions may be more likely to recognize the authority of the trustee to act on behalf of the trust.

A trust may also be a more effective way to manage assets than a power of attorney in cases of diminished capacity. If you have a power of attorney, you can continue to manage your assets as long as you are mentally capable. However, during a period of declining mental health, you may make decisions relating to your assets that you would not otherwise make. You may be able to avoid this situation if you use an alter ego or joint partner trust and appoint someone other than yourself as the trustee. Note however, that you will no longer be able to deal with the assets that you transfer to the trust if you are not a trustee, so you must be comfortable with this aspect of your plan.

6) Asset protection

Trust assets may be protected from your creditors. This is because when you transfer an asset to a trust, you transfer ownership of the asset to the trustee. Since you no longer own the asset, it may not be available to your creditors. However, if you are the income and/or capital beneficiary of the trust, your creditors may be able to lay claim to your interest in the trust. In an alter ego or a joint partner trust you, or your spouse, in the case of a joint partner trust, must be entitled to receive all the income of the trust. Therefore, these kinds of trusts may only provide a limited amount of asset protection. You may benefit from a higher level of asset protection if you are not named as a capital beneficiary of the trust or if you are not a trustee of the trust and the distribution of capital to you is entirely within the trustee's discretion.

You can also name a charity as a beneficiary of your alter ego or joint partner trust to receive the trust property upon your death, or in the case of joint partner trust, the death of the surviving spouse.

It is important to note that if you transfer assets to a trust to avoid or defeat an existing creditor, or potential future creditors, whatever trust structure you choose may not protect you against the claims of such creditors.

It is essential to obtain advice from a professional legal advisor regarding the asset protection options available to you.

Disadvantages of alter ego or joint partner trusts

Before setting up an alter ego or joint partner trust, you should consider some of the disadvantages associated with these types of trusts:

1) Cost and complexity

Setting up an alter ego or joint partner trust involves legal fees. After the trust is established, you may also incur ongoing administration costs such as accounting and/or trustee fees. Consider the time commitment that your trustee will need to make to administer the trust and file the necessary tax returns. This should also be a factor in your decision to set up the trust and in your choice of an appropriate trustee.

2) Control and flexibility

Once you transfer the assets into the trust, the trustees will assume ownership and control of these assets. You may be able to retain control of these assets if you appoint yourself as the sole or controlling trustee; however, you may not be able to achieve any asset protection, particularly if you are the capital beneficiary.

It is also important to be aware that it is generally more difficult to change the terms of a trust, including the named contingent beneficiaries, once

it is established than it is to change a Will. Changes made to the terms of the trust, as opposed to a Will, may also have tax consequences.

3) Charitable donations

If you wish to make charitable donations during your lifetime, you may want to set aside assets to carry out this intention. As previously discussed, an alter ego or joint partner trust is prohibited from distributing any of its income or capital to anyone other than you or your spouse (in the case of a joint partner trust) during your or your spouse's lifetime. Consequently, you will not be able to use trust assets to achieve your charitable objectives during your or your spouse's lifetime. You can, however, choose to donate the income or capital that you receive from these trusts to charity.

You can also name a charity as a beneficiary of your alter ego or joint partner trust to receive the trust property upon your death, or in the case of joint partner trust, the death of the surviving spouse. You may be entitled to an immediate donation tax credit for the property you transfer to the trust if you structure the trust as a charitable remainder trust. Alternatively, the trust itself may also be eligible to claim a donation tax credit on any charitable donations made directly by the trust after your death. The charitable gift must be properly structured to ensure that the amount paid to the charity by the trust is viewed as a gift and not as a payment in satisfaction of the charity's interest as a beneficiary of the trust. You should talk to a qualified tax advisor about how best to effect and structure a charitable gift by an alter ego or joint partner trust.

Alter ego and joint partner trusts can be an appealing option because of the ability to transfer capital property to the trust on a tax-deferred basis.

What kind of assets can I transfer into an alter ego or joint partner trust on a tax-deferred basis?

You can generally transfer any kind of “capital property” to an alter ego or joint partner trust on a tax-deferred basis. Capital property is “depreciable property” and any property if disposed of may result in a capital gain or a capital loss. An example of depreciable property is a building that you earn rental income on. Other types of capital property could include stocks, bonds, and mutual funds, personal-use property such as your principal residence, and private company shares. You cannot transfer non-capital property, such as inventory, into these trusts on a tax-deferred basis. Also, note that you cannot transfer your RRSP or RRIF directly into these trusts unless you withdraw the assets first. This is generally not advisable since you will pay tax on any amount you withdraw from your RRSP or RRIF in the year that you make the withdrawal.

Taxation of alter ego and joint partner trusts

As a beneficiary of an alter ego or joint partner trust, you must be entitled to receive all of the income of the trust during your lifetime. This means that all of the income earned by the trust each year must be paid or made payable to you, or to you and/or your spouse in the case of a joint partner trust. In general, the trust income paid or made payable to you will be taxed at your marginal tax rate. In the case of a joint partner trust, if the income paid or made payable to your spouse is traceable to property that you contributed to the trust, the income will be attributed back to you and taxed in your hands while you are alive.

When the settlor of an alter ego trust or the last spouse to die of a joint partner trust passes away, the trust is deemed to have disposed of all its property at its fair market value on the date of death. Under proposed legislation, which is applicable to the 2016 tax year and subsequent years, taxable capital gains arising on the death of the settlor, or in the case of a joint partner trust, on the death of the surviving spouse, will be taxable in the trust at the top marginal tax rate that applies to the trust. In addition, the trust will have a deemed year-end at the date of death. Although these proposals are not yet law, it is the Canada Revenue Agency’s long-standing practice to ask taxpayers to file on the basis of proposed legislation. That said, taxpayers remain potentially liable for taxes under current law in the event that the proposal is not passed. It is recommended that you consult a professional tax advisor with regards to these changes.

How are alter ego and joint partner trusts different from other inter vivos trusts?

Alter ego and joint partner trusts differ from other types of inter vivos trusts in a few important ways.

First, when you transfer property to an inter vivos trust, you are generally deemed to have disposed of the property at its fair market value. This could result in immediate tax consequences. Alter ego and joint partner trusts can be an appealing option because of this ability to transfer capital property to the trust on a tax-deferred basis. Alternatively, you could elect to transfer assets into either of these trusts at fair market value. You may wish to do this, for example, if you own shares of a



If you are considering setting up either an alter ego trust or a joint partner trust, weigh the potential savings in probate tax against the set-up costs of these kinds of trusts and the on-going administration expenses that may be involved.

qualified small business corporation or a qualified farm property. This would enable you to take advantage of your capital gains deduction and bump up the adjusted cost base of these assets. You can make this election to transfer property to the trust at cost or fair market value on a property-by-property basis; however, for each property it is an all or nothing election. This means that you must either transfer the property at your adjusted cost base or at fair market value and cannot choose a disposition value between your cost and the fair market value.

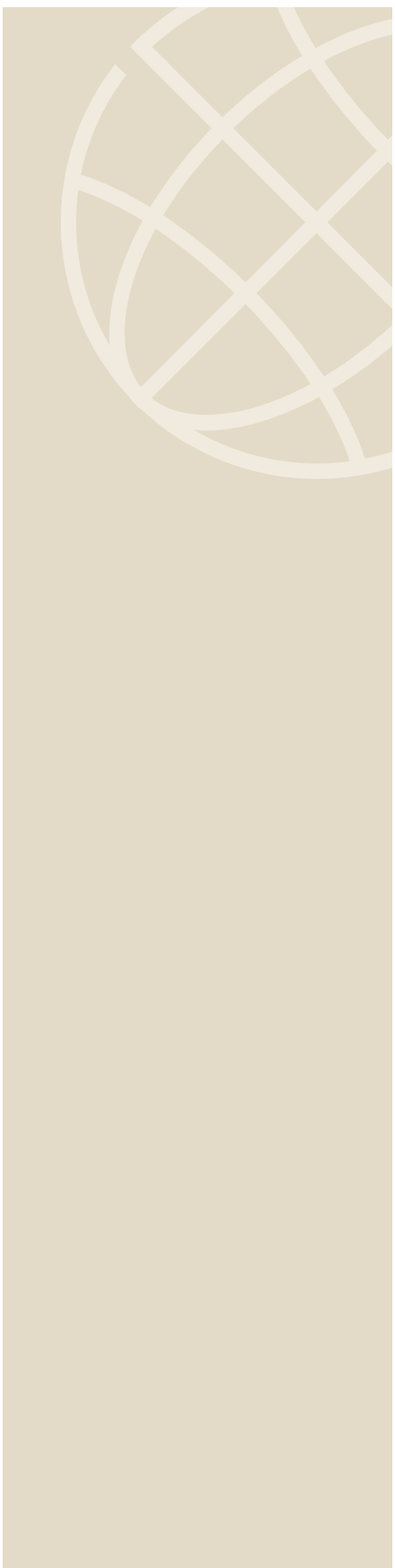
Another difference between alter ego and joint partner trusts and other types of inter vivos trusts is the application of the 21-year deemed disposition rule. Generally inter vivos trusts are deemed to have disposed of their property at fair market value every 21 years. This rule prevents a trust from accruing unrealized capital gains over a long period of time. The 21-year deemed disposition rule does not apply to alter ego or joint partner trusts. Instead, the first deemed disposition date for an alter ego trust is the date on which the settlor dies. In the case of a joint partner trust, the first deemed disposition date is the date of death of the last to die of the settlor and their spouse, regardless of whether these dates occur before or after the 21st anniversary of the trust.

Should you use an alter ego or joint partner trust?

If you are considering setting up either an alter ego trust or a joint partner trust, weigh the potential savings in probate tax against the set-up costs of these kinds of trusts and the on-going administration expenses that may be involved. As discussed previously, take into consideration the income taxes that may arise on your death, or on the death of the surviving spouse in the case of a joint partner trust. Other benefits to consider include preserving your privacy, providing continuity in the management of your property, and protecting your assets from estate litigation. Consider these potential advantages against the possibility that you may lose control of the assets you transfer into these trusts.

You may wish to consider using an alter ego or joint partner trust in the following cases:

1. You own assets of significant value which may be subject to probate tax;
2. You do not need to access the trust capital during your lifetime but you are willing to pay tax on the income earned on the assets;
3. You have assets in multiple jurisdictions;



4. You are in a second marriage and wish to provide for your spouse during their lifetime, but leave the remaining assets to your own children after your spouse's death; and/or

5. Protecting your privacy, providing continuous management for your property or protecting your assets from estate litigation is important to you.

Alter ego and joint partner trusts may be less attractive in the following cases:

1. The assets you wish to transfer to the trust are of nominal value;
2. You live in a jurisdiction that has no or minimal probate tax; and/or
3. You want to retain control over your assets.

Consult a qualified legal and/or tax professional to determine if an alter ego or joint partner trust is appropriate for your circumstances.

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