

Joint accounts

The convenience of holding assets jointly has led to the increasing use of joint accounts as a means to transfer wealth between spouses or common-law partners, or to successive generations with little or no financial or administrative consequences. In all provinces, except Quebec, accounts are often registered jointly as a way to reduce or avoid probate fees.

Estate law differs significantly in Quebec from elsewhere in Canada. The rules described in this article do not apply in Quebec when referencing joint tenants with rights of survivorship. We present this information as a matter of general professional interest and for the benefit of advisors with clients also subject to legislation in other provinces.

Joint ownership

The most common forms of joint ownership are joint tenants with rights of survivorship (JTWROS) and tenants in common (TIC).

Joint tenants with rights of survivorship

Joint tenants with rights of survivorship provides two or more persons with simultaneous rights of ownership of an account. Each joint owner has an undivided and equal legal interest in the account. In addition, each joint owner often also has an undivided and equal beneficial interest in the account. Upon the death of one joint owner, the deceased's interest in the account terminates, leaving the surviving joint owner(s) with full ownership, despite any attempted disposition in the deceased's will.

Tenants in common

Tenants in common differs from JTWROS in that there is no right of survivorship associated with it. When a co-tenant dies, his or her share passes on to his or her heirs through the will or through the rules pertaining to intestacy (where the deceased has no will).

Why joint ownership?

There are two common reasons given for registering an account as joint ownership. The most common reason is the minimization or avoidance of probate taxes. This is discussed in detail on this page, under the heading “Joint accounts and probate taxes.”

The second reason is ease of administration of the account. Many investors, particularly elderly parents, are placing their investment accounts into joint names with their adult children to facilitate dealing with the account in the future. For an alternative, please see the sidebar on page 5 entitled, “Powers of attorney: an alternative.”

Dangers of jointly held property

Before placing accounts in joint names, there are some potential risks that need to be taken into consideration. First, as discussed below, a transfer to someone other than your spouse or common-law partner may trigger immediate capital gains tax (see the heading “Deemed disposition and capital gains” on page 3). Second, a transfer of property generally means not only a loss of control over the property but quite often the inability to make decisions relating to the property without the consent of the joint owner.

Assets held in a joint account may form part of creditor proceedings if one of the joint account holders becomes insolvent or declares bankruptcy.

In addition, there is potential for real conflict upon the death of the parent, where only one child is registered as a joint owner. When the parent dies, the child becomes the sole owner of the account, which may lead to a dispute with other siblings or family members who believe that they should have a claim on the jointly held account. Finally, if the account was transferred to an adult child, it may also become open to division upon breakdown of marriage or common-law partnership of the child and his or her spouse or common-law partner.

If personal residences are involved, the dangers are even greater because each co-owner of the property may jeopardize his or her access to the principal residence exemption, as well as his or her eligibility as a “first time home buyer” for purposes of participation in the Home Buyers’ Plan.

Joint accounts and probate taxes

Except for notarial wills in the province of Quebec, it may be necessary to have a deceased’s will validated. The court process for validating the will is referred to as “probating” the will. In all provinces (other than Quebec), there is a “tax” levied by the court for submitting an application for “letters probate.” The tax is calculated as a percentage of the value of the deceased’s estate at the time of death, and there is usually no maximum.

With proper planning, probate taxes can either be avoided or at least reduced. Many strategies have been suggested as a means to reduce or avoid probate taxes, the most common being putting the property into joint ownership with right of survivorship. This is because, upon the death of one of the joint owners of an account held as JTWROS, the deceased’s interest terminates, thereby increasing proportionately the interests of the surviving joint owner(s). The deceased’s interest is sometimes said to have been transferred “outside of the estate,” but strictly speaking, there is no “transfer.” In bypassing the estate, the value of the deceased’s jointly held account is excluded from the value of his or her assets subject to probate, and thus, probate taxes are avoided on the value of the account.

However, many times, the transfer of a solely owned account to joint ownership can lead to unintended tax problems, as discussed next.

Deemed disposition and capital gains

Under the tax rules, a “disposition” occurs when there has been a change in “beneficial” ownership as opposed to a change in legal ownership. In determining whether each joint owner has beneficial ownership, a number of factors should be considered:

- Whether the account was owned by one of the joint owners prior to making it a joint account
- Evidence of the transferor’s intention to gift the account to the transferee
- Whether the income was used jointly rather than for the sole benefit of the transferor
- If the income generated by the account was reported jointly rather than solely by the transferor
- Whether the transferee actually exercised control over the account prior to death of the transferor

Where the legal owners have beneficial ownership, each joint account holder is equally responsible for the tax liability. Each must report earnings based on his or her proportionate ownership, except where the attribution rules apply (discussed under the heading “Transfer to spouse or common-law partner”).

The Canada Revenue Agency (CRA) has consistently taken the view that the transfer of property solely owned by a taxpayer into a true joint ownership arrangement (one in which beneficial ownership has changed) would result in a disposition. However, it would not be a disposition of the “full” account, but rather, only the proportionate interest that is being transferred to the transferee(s). For example, an investor who adds one person to her account would be said to have disposed of 50% of the account. Similarly, an investor who adds two children to his account would be considered to have disposed of 66 2/3% of his account.

Most transfers are generally done between the account holder and his or her spouse or common-law partner and/or his or her adult child(ren). Each of these transfers can result in very different tax consequences to both the transferor and transferee(s) and will be discussed separately.

Transfer to spouse or common-law partner

When an investor switches his or her account into joint ownership with his or her spouse or common-law partner, the tax rules state that no capital gain or loss will occur on the transfer. This is because of the automatic rollover rule, which permits capital property to be transferred between spouses or common-law partners on a tax-deferred basis. As a result, the proceeds of disposition to the transferor spouse or common-law partner would be equal to 50% of the adjusted cost base of the property. The transferee spouse or common-law partner will then be deemed to have acquired the property for an amount equal to 50% of the adjusted cost base.

An election is available to a transferor spouse or common-law partner to have the account transferred at fair market value (FMV). This might be done in situations where the transferor spouse or common-law partner has unused capital losses from the disposition of other properties (either in the current year or carried forward from prior years) which could offset the capital gain triggered on the transfer. In such a case, the transferor spouse or common-law partner will elect to have transferred 50% of the property at its fair market value and the transferee spouse or common-law partner will be deemed to have acquired the property at that same fair market value.

Note, however, that attention must be paid to the attribution rules, which generally apply when adding a spouse or common-law partner’s name to an account. All income and capital gains (losses) generated from the transferred property will generally be attributed back to the transferor spouse or common-law partner. This results in the original transferor spouse or common-law partner being responsible for tax on income earned by the account. There are some exceptions to the attribution rules which are beyond the scope of this piece – for more information, please see our Tax & Estate InfoPage *Income-splitting opportunities*.

Transfers to adult child(ren)

Where an adult child is being added to an account, the transfer or gift will normally trigger a capital gain (loss) through a disposition of half the account. This may be problematic for the transferor, particularly in cases where the property being transferred has appreciated significantly. Tax may be due on the deemed disposition yet no cash may be available to pay the resultant tax bill.

The new joint owner – the son or daughter – acquires the account at FMV. Each account holder will be taxed on 50% of any future income and/or capital gains (losses) generated by the account. Upon the death of either joint owner, there will be a disposition of the 50% interest owned by the deceased joint owner and a capital gain (loss) may result.

Example one

Marie owns a mutual fund account with a fair market value of \$150,000. Her adjusted cost base (ACB) of the fund in the account is \$100,000. She decides to add her adult daughter, Shannon, as a joint owner of the account. Upon doing so, Marie is deemed to dispose of a 50% interest in the account. She will be deemed to receive proceeds of disposition of \$75,000 for her 50% interest with an ACB of \$50,000 resulting in a capital gain for the year of transfer of \$25,000.

The use of a “side document”

To avoid the problem of having capital gains triggered when an account is registered in joint names with an adult child, some advisors have suggested the use of a “side document.” This document is generally in the form of either a statutory declaration or declaration of trust stating that the child(ren) added to the account has only a legal interest and not a beneficial interest in the account. As discussed above, for income tax purposes, capital gains are not triggered unless there is a change in beneficial ownership.

The CRA has commented on several occasions that if, in fact, the beneficial ownership of the account has not changed, no disposition for tax purposes will have occurred on the transfer of the account to joint ownership. As a result, the parent would not be faced with a capital gain upon the transfer of the account and the child(ren) would not be faced with a capital gain, nor would they automatically get their share of the proceeds of disposition should the parent decide to sell the property at a later date (prior to his or her death).

The problem with this strategy is that it may not be effective to avoid probate taxes on the value of the account when the parent dies. The reason is that in such a situation, a beneficial or equal joint tenancy arrangement does not exist. This type of beneficial or joint tenancy must have several attributes, one of which is known as the “unity of interest,” which means that each of the co-owners’ interests must be equal in nature, extent and duration. If a child signs a document that he or she has “no beneficial interest” in the account, then surely his or her interest and that of the transferor parent are not equal.

Note, however, that whether this “side document” is effective to reduce probate taxes is not the same issue as whether this tactic is effective to avoid the need to actually obtain probate letters. If all of the parent’s property is registered in joint tenancy with his or her child(ren), third parties who have possession of, or who control title or registration of the jointly owned account, will have no reason to question the manner in which the title of the account is registered. Upon receipt of proof of death, these third parties would simply reregister the account in the child(ren)’s name without requiring probate. However, if even one of the parent’s assets is left in his or her name and probate is required to transfer that asset, the full value of all of the parent’s property (including jointly registered accounts) must be included in valuing his or her estate and calculating the tax owing.

Disappointed beneficiaries and joint accounts

The concept of resulting trust in joint accounts was addressed in two rulings from the Supreme Court of Canada (SCC) in May 2007. Both cases arose out of estate challenges where a father gratuitously added a daughter as a joint owner to an investment account. In each case, the respective daughter had the onus to rebut the presumption of resulting trust, meaning each had to show that a beneficial transfer was intended.

In *Pecore v. Pecore*, the daughter's ex-husband alleged that the joint ownership was only for convenience and to avoid probate, and that the account funds should be distributed in accordance with the father's will (in which the husband was named as a beneficiary).

In *Saylor v. Madsen*, it was the daughter's two siblings who similarly claimed that the joint ownership was merely a convenience and probate avoidance manoeuvre.

While the facts worked in opposite directions in the two cases – in favour of the daughter in *Pecore v. Pecore* and for the challengers in *Saylor v. Madsen* – perhaps the most interesting aspect of the case was the SCC's statement that joint ownerships may be characterized as a lifetime transfer of a survivorship interest at death.

In fact, the SCC suggests that such an ownership structure will avoid probate tax and may not trigger capital gains tax until death. While the strict issue before the court was the legal entitlement to the account, the further comments certainly bear consideration on any addition of joint owners. In fact, it may be prudent to have a client obtain an opinion from an estate planning lawyer before making any changes, and to employ a side document to make intentions clear.

Joint accounts and death

Upon the death of one of the joint owners of an account registered as JTWROS, the deceased will be deemed to have disposed of his or her share of the account for proceeds equal to the FMV of his or her portion of the account. Any resulting capital gain (loss) would be reported on the deceased's terminal tax return for the year of death. The surviving joint owner would be deemed to acquire the deceased's portion at FMV and would adjust his or her ACB accordingly.

Note that if the joint owner is a surviving spouse or common-law partner, the proportionate share of the account would be transferred at ACB unless an election was made in the deceased's terminal return to have the asset transferred at fair market value.

A similar tax result would occur if the account was held as tenants in common except that the estate as opposed to the surviving tenant in common would be deemed to acquire the deceased's portion of the account at FMV.

Powers of attorney: an alternative

Depending on personal circumstances, a power of attorney for property is an alternative to joint registration. A power of attorney gives one or more people the authority to manage a specific account (referred to as a "limited power of attorney"), or your overall financial affairs (called a "general power of attorney") if you cannot do so because of temporary absence from the country, accident, disability or other infirmity. Your representative (called an attorney or mandatory in Quebec) has the authority to make decisions, but does not have any ownership of your assets. This authority ends upon your death, or at any time you decide to terminate the power (providing you are mentally capable to do so). For a more detailed discussion of powers of attorney, please refer to our Tax & Estate InfoPage on *Incapacity - Planning ahead helps*.

Example two

Continuing from "Example one" on page 4, Marie dies when the value of her jointly held account was \$160,000. Upon her death, there would be a deemed disposition of her interest in the account for proceeds equal to her share of the FMV or \$80,000. Since the ACB of her remaining 50% interest is \$50,000, she will recognize a capital gain reportable on her terminal return of \$30,000. In total, she will have reported a capital gain of \$25,000 upon the transfer to Shannon and a capital gain of another \$30,000 upon death, for a total capital gain of \$55,000.

CRA and joint accounts

A 2003 tax case, *Oolup v. the Queen*, further highlights the risk that continues to exist with the joint registration of assets.

The facts

After Ms. Oolup's mother died, she became very close to her grandparents, visited them regularly and helped manage their affairs. The grandparents' savings were held jointly in a GIC account to which Ms. Oolup's name was also added.

After the death of her grandparents, Ms. Oolup became the executrix of her grandmother's (the last to die) estate. For "reasons of family harmony," Ms. Oolup chose to keep only \$10,000 from the \$200,000 GIC account and to divide the rest equally among her grandmother's children (and their heirs) in accordance with the terms of her grandmother's will.

CRA's position

The CRA, relying on the theory of "resulting trust," argued that the \$200,000 GIC account was not a true joint ownership and instead formed part of Ms. Oolup's grandmother's estate. As a result, the \$10,000 was paid to Ms. Oolup from that account for services rendered as executrix of the estate and thus should be taxable.

Ms. Oolup's defense

Ms. Oolup testified that although she knew her grandmother wanted her to have the GICs "because of all the time they had spent together," she "didn't feel comfortable" with the idea of keeping all the money for herself. She was also livid at the prospect that her relatives might conclude that the money had been her motivation behind her devotion to her grandparents. To avoid this, she chose to share all but \$10,000 of "her" GIC money with her family.

The ruling

The judge found that, based on the evidence, there was no "resulting trust" and that the GIC funds became Ms. Oolup's property following her grandmother's death. As a result, the \$10,000 retained by her as the surviving joint account holder was not received as executor's fees and therefore was tax-free to her.

Conclusion

While Ms. Oolup was indeed successful in keeping her inheritance tax-free, this case should serve as a significant estate planning lesson. It is evident that the CRA can take the position that a joint account is not truly a joint account. But what if the facts in the case were different. One can clearly envisage the CRA taking the opposite position where a parent had added an adult child's name to their joint account "for estate planning purposes only," the parent's intention being that it would be a "resulting trust" and there was to be no transfer of beneficial ownership. The CRA could argue that in this case there was indeed a disposition of half the account and demand any capital gains tax be paid at that time. It behooves all investors to take joint accounts seriously and, in fact, if they are simply trying to give the child control over the account, the best route may indeed be a Power of Attorney (see page 5).

Ease of administration

In order to effect the re-registration of an account not held jointly into the name of a surviving beneficiary under the will (or under the laws of intestacy), it is usual practice for financial institutions to request letters probate before the assets are transferred (some *de minimus* rules may apply). However, in the case of JTWROS accounts, generally only a notarial copy of a death certificate is required to effect the transfer.

In-trust accounts

"In-trust accounts" or informal trusts as they are often called, are used by parents to invest funds on behalf of minors who do not have the legal capacity to enter into a binding contract. Because of the nature of in-trust accounts, they cannot be held as JTWROS or TIC. However, it is possible to register the account in the names of two adults who would each act as "co-trustees" on the account: for example, "Jack and Jill Smith in trust for Johnny Smith." The advantage of doing this would be in case one trustee dies, the other trustee could take over control of the account immediately with little administrative hassle. For more information, please consult our Tax & Estate InfoPage on *In-trust Accounts*.

Registered Education Savings Plans

Registered Education Savings Plans (RESPs) are tax-deferral tools whereby a subscriber can save for a beneficiary's post-secondary level education. An RESP can have joint subscribers, but the subscribers must be spouses or common-law partners.

The advantage to doing so is that either spouse or common-law partner (or both) may be able to receive an accumulated income payment if the conditions for such payments are met. In addition, the surviving spouse or common-law partner could take control of the account automatically upon the death of his or her joint subscriber spouse or common-law partner. For more information, please consult our Tax & Estate InfoPage on *Registered Education Savings Plan*.

Conclusion

In many cases, whether or not joint accounts are advisable for estate planning purposes will depend on the client's desire to focus on saving probate taxes or deferring income taxes. Some exceptions to this trade-off exist if the account was registered jointly from the start so that no capital gains tax is payable upon the transfer or when the owner faces a capital loss at the time of the transfer to a joint account. Finally, investors should remember that a transfer into joint names generally results in a loss of control, which may not be the desired intent.

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