

## Alter Ego Trusts

### What is an alter ego trust?

When most people think of a trust, they think of a trust under a Will, a testamentary trust. This occurs when a person makes a bequest in their Will; for example, an individual leaves money to a grandchild to be held in trust until the age of 21. However, trusts may also be set up by a living donor transferring assets to a trust. These trusts are referred to as “inter vivos” or between living persons. Inter vivos trusts can be used for a variety of reasons, such as estate planning, contingency planning, protecting assets, making charitable donations and protecting beneficiaries who either have difficulties in managing their cash flow or who have personally challenging situations.

The following two types of trusts can be utilized specifically by seniors to help achieve their financial and estate planning goals:

- An alter ego trust is an inter vivos trust set up by a person (the “settlor”) who is also the person who benefits from the trust (the “beneficiary”). The individual settles his/her property into the trust.
- A joint partner trust is similar to an alter ego trust except that both the settlor and his / her spouse or common-law partner will benefit from the trust. In this article, the terms spouse or common-law partner will be referred to as the “Partner”.

This article will outline the requirements that must be met before an alter ego or joint partner trust solution can be considered and will help identify certain pros and cons of these trust solutions, together with examples where these trusts can be used.

The requirements are essentially the same for a joint partner trust. Both alter ego and joint partner trusts will provide income and capital to individuals who are named as ‘contingent’ beneficiaries in the event of the death of the primary beneficiaries.

### Requirements for an alter ego trust

Four requirements are set out in the *Income Tax Act*:

1. The trust must be created by an individual (the settlor) who is at least 65 years old.  
Note: In the case of a joint partner trust, the Partner does not need to meet this age requirement.
2. The trust must be created after 1999.
3. Both the settlor and the trust must be resident in Canada. Note: the residence of a trust is normally determined by where the trustees reside.
4. The terms of the trust must ensure that during the lifetime of the settlor:
  - the settlor is entitled to receive all the income from the trust; and
  - no person other than the settlor may receive any income or capital from the trust.

### Alter ego trusts provide a number of benefits

#### Orderly administration of assets and continuity in case of incapacity or death

The alter ego trust can function as an alternative to a continuing power of attorney as trust documents tend to set out in very clear terms the powers and duties of a trustee. By appointing substitute or other trustees as part of the trust agreement, continued administration of the trust assets can be achieved if the settlor becomes unable to manage his/her financial affairs.

#### Minimize the impact of the probate process and costs

Upon the settlor’s death, the assets in an alter ego trust will be distributed according to the terms of the trust document rather than according to the settlor’s Will. Insofar as the trust assets are concerned, a potentially lengthy probate process as well as the probate fees can



be avoided. The trustee also has uninterrupted access to the trust assets.

In addition, if the settlor holds assets in foreign jurisdictions, an alter ego trust may also simplify the administration, since the trustees will already have authority to deal with them. By contrast, if the assets form part of the settlor's estate, the executors will likely be required to obtain probate in the foreign jurisdiction, adding time and cost to the process.

### **Privacy**

A growing concern relates to personal privacy. A Will becomes a public document once it is submitted to probate, and is available for inspection for anyone who wishes to view it. A trust document, on the other hand, remains confidential and need not be subject to public inspection.

### **Protection against the Wills Variation Act**

In British Columbia, the *Wills Variation Act* allows the Partner and children to apply to court to modify the terms of the Will, if the deceased has not made adequate provision for their support. Since the assets in an alter ego or joint partner trust do not form part of the settlor's estate, those assets are not subject to the *Wills Variation Act* claims. The settlor may have greater comfort that his/her intentions will be carried out after his death.

### **Tax treatment of alter ego trusts**

It is important to note that the alter ego trust is generally tax neutral while the settlor is alive. All income and capital gains/losses are allocated back to the settlor and in effect, the personal tax return looks the same.

The most important benefit of the alter ego trust is that tax savings may be realized by transferring capital property with an unrealized gain through a rollover to the trust. Generally when assets are transferred into a trust, these are considered to have been sold at fair market value; a "deemed disposition" has occurred which results in an immediate capital gains liability. With the rollover transfer, the deemed disposition and resulting tax liability is deferred until the death of the settlor (and in the case of a joint partner trust, the death of the last surviving Partner). It is important to note however that any accrued gains or losses based on the fair market value will be realized and taxed at the highest marginal rates. In a situation where an alter ego trust is not used, the death of a taxpayer will trigger a deemed disposition of assets which is taxed based on the individual's graduated tax rates.

Choosing an alter ego trust really comes down to the specific need and timing. If the preference is to defer the capital gains and offset the higher future tax liability with other deductions, then an alter ego trust may be a good choice. Conversely an alter ego trust may be less appealing if there is no immediate financial benefit to deferring the taxable gains, for example, if the settlor has capital losses which can offset gains on the disposition.

### **Inter-provincial tax planning**

Taxpayers may be able to enjoy tax savings by utilizing an alter ego trust that resides in a lower-tax province. For the trust to be considered resident in the lower-tax province, the majority of the trustees (i.e. people other than the settlor) must be residents in that province and the settlor must be comfortable in having others manage the assets.

### **Considerations**

In addition to legal fees involved when the trust agreement is prepared, there are also ongoing legal and accounting fees associated with the administration of the trust. An alter ego trust is considered as a separate taxpayer under the *Income Tax Act* which requires a tax return to be filed annually. There may also be trustee fees if a professional trustee is used.

### **Non-Financial considerations in establishing an alter ego trust**

**Caregiver influence:** With the aging population, there are concerns about the influence of caregivers who can be either family or non family members. Having an alter ego trust in place can guard against vulnerable individuals being persuaded to change their Will to benefit the caregiver.

**Keeping assets in the family:** For a parent who is concerned about a child's relationship with a Partner or the influence of the Partner, an alter ego trust may help ensure that assets remain within the family.

**Protecting beneficiaries:** After the death of the settlor, the trust can provide income and capital preservation for minors or dependents; it can be a good solution for those who either cannot effectively manage their money or for individuals who have personal issues.

**Second Marriages:** An alter ego trust permits assets to be distributed to specific family members at death. For example, the trust can help ensure that assets are transferred to children of a first marriage, thus avoiding the risk of a surviving Partner distributing the assets in a manner not intended by the settlor.

### In Conclusion

The alter ego trust option can be valuable in estate and incapacity planning, but there may be potential costs involved in its use. As with any financial planning, it is essential that professional advice be obtained.

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