

Joint accounts

TAX & ESTATE BULLETIN



The convenience of holding assets jointly has led to the increasing use of joint accounts as a means of transferring wealth between spouses 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.

As estate law differs significantly in Quebec from elsewhere in Canada, the rules described in this article do not apply 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* or JTWRORS and *tenants in common* or TIC. The Canada Customs and Revenue Agency (or CCRA) assumes jointly held accounts are JTWRORS unless proven otherwise.

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 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 JTWRORS only 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 below under the heading "Joint Accounts & 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 inset on page 3 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. Firstly, as discussed below, a transfer to someone other than your spouse may trigger immediate capital gains tax (see below under the heading "Deemed Disposition & Capital

Gains”). Secondly, 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 marriage breakdown of the child and his or her spouse.

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 principle 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 & 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, except in Alberta where the tax is currently capped at \$400, 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 & 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 (e.g., via the will);
- 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; and
- 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” below).

The CCRA 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 per cent of the account. Similarly, an investor who adds two children to his account would be considered to have disposed of 66 2/3 per cent of his account.

Most transfers are generally done between the account holder and his or her spouse 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

When an investor switches his or her account into joint ownership with his or her spouse, 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 on a tax-deferred basis. As a result, the proceeds of disposition to the transferor spouse would be equal to 50 per cent of the adjusted cost base of the property. The transferee spouse will then be deemed to have acquired the property for an amount equal to 50 per cent of the adjusted cost base.

An election is available to a transferor spouse to have the account transferred at fair market value. This might be done in situations where the transferor spouse 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 will elect to have transferred 50 per cent of the property at its fair market value and the transferee spouse 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'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. This results in the original transferor spouse 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 bulletin – for more information, please see our *Income Splitting Tax & Estate Bulletin*.

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 fair market value or FMV. Each account holder will be taxed on 50 per cent 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 per cent 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, or 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 per cent interest in the account. She will be deemed to receive proceeds of disposition of \$75,000 for her 50 per cent interest with an ACB of \$50,000 resulting in a capital gain for the year of transfer of \$25,000.

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 *mandatary* 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 the *Incapacity – Planning Ahead Helps Tax & Estate Bulletin*.

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 CCRA 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 letters probate. 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.

Joint accounts & 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, 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.

EXAMPLE TWO

Continuing from Example One above, 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 fair market value 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.

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 rule 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 on in-trust accounts, please consult our *In-Trust Accounts* Tax & Estate Bulletin.

Registered Education Savings Plans

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

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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