ALTER-EGO AND JOINT SPOUSAL OR COMMON-LAW PARTNER TRUSTS

IN ESTATE PLANNING

By Kim G C Moody, CA, TEP

A. INTRODUCTION

On June 14, 2001 Bill C-22 received Royal Assent and was passed into law. Included in Bill C-22 were certain trust proposals first introduced on December 23, 1998 and subsequently amended on December 17, 1999 and the June 5, 2000 Notice of Ways and Means Motion ("NWMM") which introduced the concepts of alter-ego and joint spousal or common-law partner trusts. Many articles have been written on these new types of trusts and the related applications. Some of these writings will be referred to throughout. Accordingly, the purpose of this paper is to review the new provisions, to discuss obvious planning opportunities with respect to the new trusts and to summarize these planning opportunities with a brief case study. All statutory references are to the Income Tax Act, R.S.C. 1985, c.1 (5th Supp.), as amended (the "Act"). The Canada Customs and Revenue Agency (formerly Revenue Canada) is referred to as the "CCRA".

B. A TECHNICAL REVIEW

Definition of Alter-Ego Trust

An alter-ego trust is defined under subsection 248(1) of the Act. The definition in subsection 248(1) refers the reader to paragraph 104(4)(a) with certain exceptions. An alter-ego trust is a trust which must meet the following conditions:

(a) Is a trust that was created after 1999;³

(b) Is an inter-vivos trust;⁴

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¹ Of Moody Shikaze Boulet Chartered Accountants, LLP, Calgary, Alberta. Thanks to Siân Stephenson, LL.B., TEP of Bennett Jones LLP for her most helpful comments on the writing of this paper. In addition, thanks to Dennis L. Nerland, LL.B. of Shea Nerland Calnan Barristers and Solicitors, Calgary, Alberta for his most helpful comments.
³ See subparagraph 104(4)(a)(ii.1) for this requirement.
Under the terms of the trust deed, the taxpayer alone is entitled to receive all of the income of
the trust that arises before the taxpayer's death and no person except the taxpayer may, before
the taxpayer's death, receive or otherwise obtain the use of any of the income or capital of the
trust;\(^4\)

The person creating the trust must have attained the age of 65 years at the time the trust was
created;\(^6\) and

Is a trust that does not elect out of the provision to be an alter-ego trust.\(^7\)

The alter-ego trust definition effectively extends the existing spousal trust rules\(^8\) to allow the settlor to be a beneficiary as well. This type of flexibility can be very useful.

**Joint Spousal or Common-Law Partner Trust**

A joint spousal or common-law partner trust is defined under subsection 248(1). Again, subsection 248(1) refers the reader to paragraph 104(4)(a) with certain exceptions. In the 1999 draft legislation, these types of trusts were called joint spousal trusts. In the June 5, 2000 NWMM, these trusts were called joint partner trusts, but now the Department of Finance and the Government appear to have settled on the phrase "joint spousal or common-law partner trust". The following conditions must be met in order to meet the definition of a joint spousal or common-law partner trust:

(a) Is a trust that was created after 1999;\(^9\)

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\(^4\) See subparagraph 104(4)(a)(ii.1) for this requirement. See also subsection 108(1) for the definition of an inter-vivos trust which defines an inter-vivos trust to mean a trust other than a testamentary trust. A testamentary trust is also defined under subsection 108(1).

\(^5\) See Clause 104(4)(a)(iv)(A) for this requirement.

\(^6\) See subparagraph 104(4)(a)(iv) for this requirement.

\(^7\) Subparagraph 104(4)(a)(ii.1) contains excepting language which allows the trust to elect in its first return of income (in other words its first T3 that will be filed) for its first taxation year for subparagraph 104(4)(a)(ii.1) to not apply, thus causing the trust to not be an alter-ego trust. This is important when dealing with the deemed disposition rules under 104(4)(a) in determining when the trust will be deemed to have disposed of its assets. In general, if the trust is not an alter-ego trust it will be subject to the normal 21-year deemed disposition rules under subsection 104(4).

\(^8\) The spousal trust rules in subsection 73(1.01) essentially allows capital property to be transferred during lifetime from an individual to their spouse or common-law partner or a valid trust for the benefit of the spouse or common-law partner without the incidence of tax.
(b) The trust is an *inter-vivos* trust;\(^9\)

(c) Under the terms of the trust, the taxpayer or the taxpayer’s spouse or common-law partner\(^11\) was, in combination with the spouse or common-law partner or the taxpayer, as the case may be, entitled to receive all of the income of the trust that arose before the later of the death of the taxpayer and the death of the spouse or common-law partner and no person could, before the later of those deaths, receive or otherwise obtain the use of any of the income or capital of the trust;\(^12\) and

(d) The person creating the trust must have attained the age of 65 years of age at the time the trust was created.\(^13\)

Again, the concept of a joint spousal or common-law partner trust extends the spousal trust rules in subsection 73(1.01) to allow the settlor to be a beneficiary as well. One will also note that when compared to the requirements for an alter-ego trust, the joint spousal or common-law partner trust allows for the addition of the spouse or common-law partner as a beneficiary. In addition, the alter-ego trust rules allow for the trust to except out of the definition of an alter-ego trust whereas such an exception is not available for a joint spousal or common-law partner trust.\(^14\)

It is important at this point to note that the definition of spouse\(^15\) under the Act was repealed by the *Modernization of Benefits and Obligations Act*\(^6\) effective for the 2001 and later taxation years or earlier

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\(^9\) See subparagraph 104(4)(a)(ii.1).
\(^10\) *Supra*, footnote 4.
\(^11\) "Common-law partner" is defined under subsection 248(1) to mean a person who cohabits at that time in a conjugal relationship with the taxpayer and

(a) has so cohabited with the taxpayer for a continuous period of at least one year, or

(b) would be a parent of a child of whom the taxpayer is a parent, …"

\(^12\) See Clauses 104(4)(a)(iv)(B) and (C) for these requirements.
\(^13\) *Supra*, footnote 6.
\(^14\) The exception language in 104(4)(a)(ii.1) is very specific and only allows for a trust which would otherwise be an alter-ego trust to except out of the alter-ego trust rules. An exception is not available for a joint spousal or common-law partner trust under this section.
\(^15\) Under former subsection 252(4).
\(^16\) S.C. 2000, c. 12.
by election. The definition of spouse was replaced by the definition of common-law partner in subsection 248(1). Such an amendment to the Act was precipitated by the Ontario Court of Appeal case in *Rosenberg v. Canada*\(^{17}\) which dealt with whether or not the CCRA could refuse to register a pension plan with a same sex couple. The court ruled that such a pension registration could occur notwithstanding that the definition of spouse required that the person be of the opposite sex from the other. The term "spouse" continues to be utilized in the Act and refers to legally married couples and not common-law partners.

**Section 73 and the Interaction with Alter-ego and Joint Spousal or Common-law Partner Trusts**

One of the unique aspects of utilizing alter-ego and joint spousal or common-law partner trusts is the ability to transfer capital property on a tax-deferred basis to the trust. This rollover is not available for any other type of trust. For example, if Mr. Apple was to transfer his shares of Opco to a "normal" *inter-vivos* family trust that was not an alter-ego or joint spousal or common-law partner trust, the transfer of Opco's shares to the family trust would result in a disposition at fair market value, thus creating a capital gain for Mr. Apple to the extent that the fair market value of the shares exceed the adjusted cost base. However, to the extent that Mr. Apple were to transfer such Opco shares to an alter-ego or joint spousal or common-law partner trust utilizing the specific conditions of section 73, no capital gain would result. This unique opportunity can be very beneficial in estate planning.

Section 73 has been amended to specifically allow for a transfer of capital property to an alter-ego trust and joint spousal or common-law partner trust.\(^{18}\)


\(^{18}\) The language of section 73 does not specifically state that transfers of capital property to alter-ego and joint spousal or common-law partner trusts are on a rollover basis. Instead, the rollover provision language of section 73 in subsections 73(1.01) and (1.02) specifically incorporates much of the language of subparagraph 104(4)(a) to identify the trusts.
In order for an individual to transfer property to an alter-ego trust, the trust must meet the following conditions:

(a) The trust must be created after 1999;\(^{19}\)

(b) The trust is an *inter-vivos* trust;\(^{20}\)

(c) The individual who transfers property to the trust must have attained 65 years of age at the time the trust was created;\(^{21}\)

(d) Pursuant to the trust deed, the individual is entitled to receive all of the income of the trust that arises before the individual’s death and no person except the individual may, before the individual’s death, receive or otherwise obtain the use of any of the income or capital of the trust;\(^{22}\) and

(e) The trust does not make an election to have the alter-ego trust rules not apply.\(^{23}\)

In order for transfers to occur on a rollover basis by an individual to a joint spousal or common-law partner trust, pursuant to the rules in section 73, the following conditions must be met:

(a) The trust was created after 1999;\(^{24}\)

(b) The trust is an *inter-vivos* trust;\(^{25}\)

(c) The individual who transfers property to the trust must have attained 65 years of age at the time the trust was created;\(^{26}\) and

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\(^{19}\) See paragraph 73(1.02)(a).
\(^{20}\) *Supra*, footnote 4
\(^{21}\) See subparagraph 73(1.02)(b) (i).
\(^{22}\) See subparagraph 73(1.01)(c)(ii).
\(^{23}\) The election by the trust to not have the alter-ego trust rules apply is in subparagraph 104(4)(a)(ii.1).
\(^{24}\) See paragraph 73(1.02)(a).
\(^{25}\) *Supra*, footnote 4.
\(^{26}\) See subparagraph 73(1.02)(b)(i).
(d) Under the terms of the trust, either the individual, the individual's spouse or common-law partner is, in combination with the other, entitled to receive all of the income of the trust that arises before the later of the death of the individual and the death of the spouse or common-law partner (as the case may be) and no other person may, before the later of those deaths, receive or otherwise obtain the use of any of the income or capital of the trust.\(^{27}\)

To the extent that the above conditions are met for an alter-ego or joint spousal or common-law partner trust, the individual can transfer capital property to the trust and have the "rollover"\(^{28}\) rules apply. It is important to note that in order for the deferral of tax on the transfer of capital property to apply, both the individual and the transferee trust must be resident in Canada. Accordingly, to the extent that the individual is a non-resident of Canada, the rollover rules will not apply.

Notwithstanding the existence of the rollover rules that may apply to the transfer of capital property by an individual to an alter-ego or joint spousal or common-law partner trust, there may often times be circumstances where such a rollover is not desirable. For example, to the extent that an individual may hold qualified small business corporation shares\(^{29}\) or qualified farm property,\(^{30}\) the individual may desire to trigger a capital gain on such a disposition to the applicable trust so as to utilize his or her available capital gains deductions\(^{31}\) applicable to such property. Such a triggering of the capital gain will result in a "bump" to the adjusted cost base\(^{32}\) of the applicable property for the trust. Subsection 73(1) allows for the

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\(^{27}\) See clauses 73(1.01)(c)(iii)(A) and (B) for these requirements.

\(^{28}\) The rollover rules are existent in subsection 73(1). Such rollover rules will deem the particular property to have been disposed of by the individual for proceeds equal to:

(i) where the particular property is depreciable property of a prescribed class, that proportion of the undepreciated capital cost to the individual immediately before that time of all property of that class at the fair market value immediately before that time if the particular property is of the fair market value immediately before that time of all that property of that class, and

(ii) in any other case the adjusted cost base to the individual of the particular property immediately before that time.

\(^{29}\) As defined under subsection 110.6(1).

\(^{30}\) *Supra*, footnote 29.

\(^{31}\) Under subsection 110.6(2) or (2.1) as the case may be.

\(^{32}\) As defined under section 54.
individual to elect in the individual's return of income for the taxation year in which the property is transferred that the provisions of subsection 73(1) do not apply. Accordingly, this election can be very useful in certain circumstances.

In order to prevent certain mischief and the possible avoidance of the taxpayer migration rules, an anti-avoidance rule has been added in paragraph 104(4)(a.3) to deem the trust to have disposed of its property at fair market value in circumstances to which an individual transferred property to the trust where subsection 73(1) applied and it was reasonable to conclude that the property was so transferred in anticipation that the taxpayer would subsequently cease to reside in Canada. If the taxpayer subsequently ceases to reside in Canada, the trust will be deemed to have disposed of its property at that fair market value immediately after each time at which the taxpayer ceases to be resident in Canada.

New expanded section 73 also contains language which enables an individual to transfer property to a trust whose only beneficiary is the settlor and no other person can have an absolute or contingent right as a beneficiary under the trust. In such circumstances, the transferor does not need to meet the age 65 limitation. Such a trust has been referred to as a "self-benefit trust" which can also be very useful in many circumstances. However, the technical rules surrounding a self-benefit trust are beyond the scope of this paper and will not be discussed further. In addition, new section 107.4 allows for certain transfers of property to a "qualifying disposition" trust where certain conditions are met. Again, the technical rules surrounding a qualifying disposition trust are beyond the scope of this paper and will not be discussed further. Nevertheless, the reader should be aware of such opportunities.

33 Under subsection 128.1(4).
34 See also new paragraph 107.4(3)(h) which deals with a subsequent disposition by the trust to a new trust.
35 See subparagraph 73(1.02)(b)(ii).
36 As that phrase is described in Cindy L. Rajan and Catherine Brown, "Personal Trusts 2000 – Taxation and Planning in the New Millennium" in Report of the Proceedings of the 52rd Tax Conference, 2000 Conference Report (Toronto: Canadian Tax Foundation, (2000)). This paper is an excellent paper which describes much of the new trust legislation in very great detail. The author encourages the reader of this paper to review Cindy Rajan and Catherine Brown's paper for further issues surrounding self-benefit trusts. However, since the release of Cindy Rajan and Catherine Brown's paper, many of the technical rules have changed with respect to "self-benefit" trusts; therefore, please review the legislation carefully.
Subsection 75(2)

Subsection 75(2) of the Act must be closely looked at in any planning involving alter-ego or joint spousal or common-law partner trusts. Subsection 75(2) is an attribution provision which reads as follows:

"Where, by a trust created in any manner whatever since 1934, property is held on condition

(a) that it or property substituted therefor may

(i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as "the person"), or
(ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or

(b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,

any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person."

As the reader can see, to the extent that the conditions for application under paragraph 75(2)(a) and (b) are met, any income or loss from a property, or from the property substituted, or any taxable capital gain or allowable capital loss, shall during the lifetime of the person or the persons resident in Canada, be deemed to be income of that person. Accordingly, in a "standard" alter-ego or joint spousal or common-law partner trust, if property is transferred by an individual to a trust of which they are perhaps both a
trustee and a capital beneficiary, subsection 75(2) will apply to attribute any income or capital gain of the trust to the transferor individual during the lifetime of that individual. This attribution can result in very restrictive planning with respect to the trust income. Without any planning, the income or capital gain of the trust will always be attributed back to the individual. In some circumstances, such as probate planning (discussed later in the paper), this result may be acceptable. However, in circumstances where it is desirable to have the income taxed in the trust (such as provincial rate shopping – also discussed later), the result of subsection 75(2) may not be desirable.

A key element in tax planning for trusts is the ability to transfer property to capital beneficiaries in satisfaction of all or part of their capital interest in the trust on a tax-deferred basis pursuant to subsection 107(2). However, to the extent that subsection 75(2) applies to a trust property, subsection 107(4.1) will deem a distribution of trust property to a capital beneficiary to occur at fair market value. However, this deeming rule will not apply to the extent that the taxpayer beneficiary was the transferor of the property or a spouse or common-law partner of the transferor.37

To the extent that subsection 75(2) is sought to be avoided, careful drafting by lawyers of the trust deed must be done.38

Accordingly, much of the income tax planning involving alter-ego and joint spousal or common-law partner trusts will depend on whether or not subsection 75(2) applies. To the extent that planning has

37 See the exceptions as outlined under paragraph 107(4.1)(c).
38 For example, in her paper presented at the 2001 Prairie Provinces Tax Conference, Siân Stephenson points out that if it is intended that the application of subsection 75(2) be avoided, it is good practice to include a non-reversionary clause in the trust deed which ensures that trust capital cannot revert to the settlor/contributor under any circumstances nor may that person be a capital beneficiary or receive capital distributions in the future. Further, if the contributor to the property is a trustee, majority decisions of at least three trustees should be required to avoid subsection 75(2) of the Act. Siân further points out that if the trust contains a power to vary and it is desirable to avoid subsection 75(2), it may be prudent to limit the power to vary the trust deed so that it is not possible to amend or add the settlor/contributor as a capital beneficiary. One must therefore be careful to consider the number and powers of trustees. Stephenson, Siân, "Alter Ego and Joint Partner Trusts – A Case Study", Tab 3 presented at The 2001 Prairie Provinces Tax Conference (Toronto: Canadian Tax Foundation).
been done to avoid the application of subsection 75(2), other legal considerations must be considered. For example, if the transferor is not a capital beneficiary then the transferor must be comfortable with this fact. With an alter-ego trust, this type of planning can be problematic since only the transferor individual can be a capital beneficiary. However, to the extent that careful and creative trust deed drafting is done, perhaps subsection 75(2) could be avoided. To the extent that subsection 75(2) cannot be avoided in an alter-ego trust, this may limit some of the other planning opportunities outlined later in this paper.\(^{39}\)

**Other Attribution Rules**

There are numerous attribution rules other than subsection 75(2) that may apply when utilizing the new trust rules. However, with the use of an alter-ego trust, such considerations will generally not apply since the only income beneficiary of the alter-ego trust will be the transferor individual. Accordingly, given that the general purpose of the other attribution rules contained in the Act is to limit income splitting mischief, such attribution rules will generally not apply to an alter-ego trust.

However, when utilizing a joint spousal or common-law partner trust, certain attribution provisions of the Act may apply given that certain income splitting planning could be done in the absence of the other attribution rules.

For example, subsection 74.1(1) in conjunction with subsection 74.3(1) can apply where an individual has transferred or lent property either directly or indirectly by means of a trust or by any means whatever to or for the benefit of a person who is the individual's spouse or common-law partner. To the extent that such

a transfer of property has occurred, any income or loss (as the case may be) from that transfer of property
will be deemed to be income or loss of the individual and not of the trust. For example, to the extent that
Mr. Apple transfers $1M of marketable securities to a joint spousal or common-law partner trust which
includes Mrs. Apple as a capital beneficiary, property income such as dividends or interest income from
the marketable securities will always be attributed back to Mr. Apple and will not be income of the trust.
However, to the extent that a designation under subsection 104(13.1)\textsuperscript{40} is made by the trust, such income
would be taxed in the trust and not result in section 74.1(1) applying to attribute such income back to the
transferor individual.\textsuperscript{41}

Similarly, subsection 74.2(1), in conjunction with subsection 74.3(1), applies where an individual has lent
or transferred property either directly or indirectly by means of a trust or by any means whatever to or for
the benefit of a person who is the individual’s spouse or common-law partner. To the extent that such a
transfer has occurred, any resulting capital gains or losses realized by the trust will be deemed to be that
of the transferor. For example, subsection 74.2(1), in conjunction with subsection 74.3(1), could apply
where Mr. Apple transfers marketable securities with a fair market value of $1M to a joint spousal or
common-law partner trust of which Mrs. Apple is a beneficiary. If the trust subsequently disposes of its
property and a capital gain of $600,000 is realized by the trust (assuming that the adjusted cost base of the
marketable securities is $400,000), the resulting capital gain would be attributed back to Mr. Apple for
purposes of computing Mr. Apple’s taxable income in the relevant taxation year pursuant to subsection

\textsuperscript{40} Subsection 104(13.1) and (13.2) provides a mechanism for a Canadian resident trust (with certain exceptions) to
designate an amount in respect of a beneficiary’s share of the income of a trust which, because the trust has not
deducted from its income under subsection 104(6), will be deemed not to have been paid or become payable to the
beneficiary. The effect of the designation is that the trust will be subject to taxation on such income and not the
beneficiary. For a recent case involving subsection 104(13.1) designations, see Lussier v. The Queen 99 DTC 1029.

\textsuperscript{41} See Technical Interpretation No. 9517415 dated November 1, 1995 which states that "By virtue of subsection
74.3(1), since [the] amounts are taxed in the trust and not in a beneficiary’s hands (assuming a designation is made
under subsection 104(13.1), where applicable), they will generally not be subject to the attribution rules under
section 74.1.” One would also have to consider whether or not such a designation under subsection 104(13.1) and
(13.2) could be made when subsection 75(2) of the Act applies to the trust. There is no case law directly on point,
but generally one would assume that subsection 75(2) would take priority over subsections 104(13.1) and (13.2).
74.2(1). However, to the extent that a designation under subsection 104(13.2)\textsuperscript{42} is made by the trust, the gain could be taxable to the trust resulting in subsection 74.2(1) not applying.\textsuperscript{43}

Another attribution provision that must be considered when utilizing joint spousal or common-law partner trusts is subsection 74.4(2). This provision is commonly known as the "corporate attribution" provision. This will apply where an individual has transferred or lent property either directly or indirectly by means of a trust or by any other means whatever, to a corporation and one of the main purposes of the transfer or loan may reasonably be considered to be to reduce the income of the individual and to benefit, either directly or indirectly, by means of a trust or by any other means whatever, a person who is a designated person\textsuperscript{44} in respect of the individual. To the extent that the conditions of subsection 74.4(2) apply,\textsuperscript{45} the individual will be deemed to have received interest in the year computed by reference to the "outstanding amount".\textsuperscript{46} Such a result will require the "phantom interest" income inclusion notwithstanding the fact that the transferor may not have actually received any monies from the corporation. An example can help describe the possible application of this provision.

Let us assume that Mr. Apple owns shares of "Holdco". Holdco is not a small business corporation.\textsuperscript{47} The fair market value of the Holdco shares that Mr. Apple holds is $1M. Let us further assume that Mr. Apple wishes to complete an "estate freeze" whereby he will exchange his common shares of Holdco for $1M of preferred shares of Holdco. The exchange would occur on a tax-deferred basis.\textsuperscript{48} New common shares would then be subscribed for by a joint spousal or common-law partner trust that would be settled

\begin{footnotesize}
\bibitem{supra} Supra, footnote 40.
\bibitem{supra} Supra, footnote 41.
\bibitem{designated_person} A designated person is defined under subsection 74.5(5) to be a spouse or common-law partner of the individual or a minor individual who does not deal at arm’s length with the individual or a niece or nephew of the individual.
\bibitem{other_conditions} The other conditions that require subsection 74.4(2) to apply would be that the designated person would have been a specified shareholder of the corporation (subject to certain modifications not reproduced herein), the transferor individual was resident in Canada and the corporation was not a small business corporation (as that phrase is defined under subsection 248(1)).
\bibitem{phantom_interest} As defined under subsection 74.4(3).
\bibitem{small_business_corporation} As defined under subsection 248(1).
\bibitem{estate_freeze} Utilizing either section 85, section 86 or section 51.
\end{footnotesize}
for the benefit of Mr. Apple and Mrs. Apple.\textsuperscript{49} In this example, given that it is likely that one of the purposes of such an estate freeze was to benefit, either directly or indirectly, Mr. Apple's spouse, Mr. Apple will be deemed to have received an interest benefit computed on the outstanding amount. At the present time of writing, the prescribed interest rate was five percent, therefore, the annual interest benefit that Mr. Apple would have to receive would be equal to at least five percent of the $1M.\textsuperscript{50}

Other attribution provisions should be considered when utilizing joint spousal or common-law partner trusts.\textsuperscript{51}

**Deemed Disposition Dates**

An alter-ego trust is deemed to have disposed of its trust property at the end of the day on which the death of the transferor individual occurs.\textsuperscript{52} Accordingly, the normal "21-year deemed disposition rule"\textsuperscript{53} does not apply. For example, to the extent that an individual settles an alter-ego trust at age 65, but does not pass away until age 100, the 21-year deemed disposition rule does not apply to the alter-ego trust at age

\textsuperscript{49} One would question why new common "growth" shares would be subscribed for by a joint spousal or common-law partner trust. A better alternative may be to have a non-joint spousal or common-law partner trust (i.e. an inter-vivos family trust) subscribe for the growth common shares.

\textsuperscript{50} However, prescribed interest rates are set out by the CCRA quarterly and therefore a more accurate calculation would have to be done utilizing the applicable quarterly interest rates as set out by the CCRA.

\textsuperscript{51} For example, the reader should be aware of the numerous other attribution provisions, including for example:

(a) Subsection 74.3(1) – this can apply where an individual has lent or transferred property, either directly or indirectly, by means of a trust or by any means whatever, to a trust in which another individual who is at any time a designated person in respect of the individual is beneficially interested (as defined under subsection 248(25) of the Act).

(b) Subsection 56(2) – this provision applies to indirect payments where a payment or transfer of property made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desires to have conferred on the other person. To the extent that subsection 56(2) applies, such payments or transfers will be attributed back to the transferor taxpayer.

(c) Subsection 56(4) – transfer of rights to income.

(d) Subsection 56(4.1) – applies where an individual makes an interest-free or low interest loan to a non-arm's length individual or to a trust and it can be reasonably considered that one of the main reasons for making the loan and incurring the indebtedness was to reduce or avoid tax.

The reader should also note that the above list of attribution provisions including that described in the body of the paper is not exhaustive.

\textsuperscript{52} See subparagraph 104(4)(a)(iv).

\textsuperscript{53} As outlined in subsection 104(4), unless an election was made under subparagraph 104(4)(a)(ii.1).
86 of the transferor but instead the deemed disposition of the trust assets at fair market value will apply at age 100 upon the death of the transferor.

Given that an alter-ego trust is an *inter-vivos* trust, the resulting deemed disposition by the trust upon the death of the transferor will result in the income or capital gains being taxed in the trust at the highest applicable tax rates.\(^\text{54}\) This can potentially cause additional income tax to be paid given that progressive marginal tax rates will not be available to the extent that such assets were deemed to be disposed of by the deceased individual\(^\text{55}\) immediately prior to death rather than the assets being disposed of by the trust. Accordingly, careful planning with respect to this issue must be done.

In order to prevent double taxation which would otherwise occur upon the death of the settlor/beneficiary of an alter-ego trust, adjustments to the "cost amount" are made which will "bump" the cost amount of the capital interest of the trust held by the deceased's estate to take into account the deemed disposition of the alter-ego trust property.\(^\text{56}\)

To the extent that an alter-ego trust will continue by virtue of the language in the trust deed, the "clock" will start ticking for the normal 21-year deemed disposition rule the day after the contributor individual passes away.\(^\text{57}\)

For a joint spousal or common-law partner trust, very similar rules as that for an alter-ego trust apply with respect to the deemed disposition date. However, now the deemed disposition date will be the end of the day of the later of the death of the taxpayer or the taxpayer's spouse or common-law partner (as the case

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\(^{54}\) Given that an *inter-vivos* trust is subject to the highest marginal tax rate pursuant to subsection 122(1).

\(^{55}\) Pursuant to subsection 70(5).

\(^{56}\) See the adjustment computation under paragraph (a.1) of the definition of "cost amount" in subsection 108(1). In addition, see Technical Interpretation No. 1999-0013165 which discusses this issue.

\(^{57}\) See paragraph 104(4)(c).
Again, to the extent that the trust deed allows for the joint spousal or common-law partner trust to continue upon the death of the last spouse or common-law partner, the clock will start ticking for the normal 21-year deemed disposition rule immediately after the time of the last death.  

C. SOME INTERESTING TIDBITS

Trust Receiving Property from an Alter-ego Trust

Since the introduction of the new trust rules involving alter-ego and joint spousal or common-law partner trusts, numerous questions have been posed with respect to possible rollover opportunities upon the death of the settlor and/or spouse or common-law partner. For example, to the extent that an individual dies and his will dictates that his property is to be vested indefeasibly with the surviving spouse, the deemed disposition rules under subsection 70(5) can be avoided. Accordingly, are there any rollover opportunities available for an alter-ego trust? In other words, could an alter-ego trust transfer its property to a "testamentary trust" for the benefit of the deceased's spouse or common-law partner and thus obtain a rollover pursuant to subsection 70(6). The CCRA has recently considered this question. In one technical interpretation the CCRA was asked to consider whether or not a new trust to be created upon the death of the settlor (with the new trust to be named as a contingent beneficiary of the alter-ego trust), was a testamentary trust. In addition, the CCRA was also asked to consider the situation of whether or not a new trust, which would be created by distributing the alter-ego trust property through the operation of a power of appointment exercisable through the will of the settlor, would be considered to be a testamentary trust. The CCRA opined that in both situations the newly created trust would not be considered to be a testamentary trust. The CCRA stated that since the property of the alter-ego trust does not belong to the settlor at the time of the settlor's death and thus, despite any direction given in the

58 See clauses 104(4)(a)(iv)(B) and (C).
59 Supra, footnote 57.
settlor's will with respect to this property, the property cannot be considered to be a contribution by the settlor as a consequence of the settlor's death to a trust that is created subsequent to the settlor's death.\textsuperscript{63}

Accordingly, given that a testamentary trust cannot be created by transferring property from an alter-ego trust, one must be cognizant of the loss of rollover opportunities\textsuperscript{64} that would otherwise be available to the extent that the trust property was held by the individual immediately prior to his/her death to the extent that there is a surviving spouse or common-law partner. Planning should be done to ensure that acceleration of the tax upon death does not occur. Such acceleration would not occur to the extent that the original property was transferred to a joint spousal or common-law partner trust. However, such a transfer may not always be desirable.

\textbf{Charitable Giving from an Alter-ego Trust}

The individual charitable gifting rules under the Act have significantly changed over the last number of years.\textsuperscript{65} In general, these changes have significantly improved the tax benefits for testamentary giving. For example, in recent years new legislation has been added which allows an individual's estate to utilize 100 percent (as compared to the normal 75 percent rule) of charitable donations against terminal income.\textsuperscript{66} In addition, to the extent that a deceased individual cannot fully utilize available charitable donations against terminal income, the executors of the deceased's estate can carryback such unutilized

\textsuperscript{60} This is by virtue of subsection 70(6) which will override subsection 70(5) to the extent that the deceased's property vests indefeasibly with the surviving spouse or a valid spouse or partner trust.
\textsuperscript{63} See subsection 248(9.1) which describes how a trust is created for purposes of the Act by a taxpayer's will. It states that a trust is created by a taxpayer's will only in the following situations:
(a) under the terms of the taxpayer's will; or
(b) by an order of a court in relation to the taxpayer's estate made under any law of the province that provides for the relief or support of dependents.
\textsuperscript{64} Pursuant to subsection 70(6).
\textsuperscript{65} The charitable gifting rules for an individual are outlined in section 118.1.
\textsuperscript{66} See subparagraph a(ii) of the definition of "total gifts" under subsection 118.1(1).
charitable donations to the immediately preceding taxation year. Accordingly, these rules are very flexible.

A common question arises as to whether or not the charitable donation tax credit is most effectively used in the deceased's terminal return or the deceased's estate. In many cases it would be beneficial to claim the gifts on the deceased's terminal return since there are often significant gains resulting from the deemed disposition of capital property on death. Subsection 118.1(5) provides that where an individual by virtue of the individual's will makes a gift, the gift is, for the purposes of the Act, deemed to have been made by the individual immediately before the individual died. However, one must ensure that the deceased's will is clear and gives the executors power to make such a gift so as to not cause uncertainty as to whom should be claiming the tax effect of the charitable gift.

What about a gift from an alter-ego trust? If the trust deed provides for a gift to be made upon the death of the settlor, who should be claiming the tax effect? How should the tax effect be recorded? The answer to the first question is straightforward. Given that an alter-ego trust is an inter-vivos trust and given that it is clear that a transfer of property from an alter-ego trust to a new trust upon the death of the settlor will not constitute a testamentary trust, the tax effects of the charitable gift will reside with the alter-ego trust.

The answer to the second question is a little more challenging. Should the charitable gift be considered to be a tax credit for purposes of calculating the tax payable for the alter-ego trust or should the alter-ego trust claim a deduction pursuant to subsection 104(6) for purposes of calculating its taxable income? This question was recently posed to the CCRA in a technical interpretation. The CCRA noted therein that it is a question of fact as to which provision would apply in any particular fact situation. Where the

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67 See subsection 118.1(4).
68 Subsection 104(6) generally enables a trust to claim a deduction from its taxable income for any amounts paid or made payable to its beneficiaries.
trust agreement empowers the trustees to make a gift and the trustees exercise this power, it is the CCRA's opinion that it would be appropriate for subsection 118.1(3) to apply, thus making the tax effect of the gift by the alter-ego trust a tax credit.\textsuperscript{70} On the other hand, the CCRA opined that where the charity is an income beneficiary of the trust after the death of the settlor and a distribution is made out of the trust income, subsection 104(6) would be the relevant provision thus entitling the trust to a deduction. Accordingly, trustees and advisors should review their specific fact situation carefully to ensure that the desired result will apply whenever charitable giving is contemplated from an alter-ego trust. Mathematical calculations should not be avoided in this determination and planning.

Given all of the above, it should be apparent that advisors need to consider with their clients where appropriate charitable gifts should be made. For example, would it be more effective in your client's situation to have a charitable gift occur by virtue of the deceased's will? On the other hand, would it be more appropriate to have the charitable gift done by virtue of distributing assets from an alter-ego trust? Again, mathematical analysis should not be avoided when planning in this area.\textsuperscript{71}

D. PLANNING OPPORTUNITIES

Given the above technical analysis of alter-ego and joint spousal or common-law partner trusts, the reader should likely now be aware that much of the planning opportunities related to the use of alter-ego and joint spousal or common-law partner trusts will be in the context of estate planning. Accordingly, most of the discussion below will focus on such planning.

\textsuperscript{70} The tax credit would reduce the otherwise tax payable by the alter-ego trust.
\textsuperscript{71} See Margaret R. O'Sullivan, "Using Alter-Ego and Joint Partner Trusts as Will and Power of Attorney Substitutes for the Elder Client" presented at the 2000 Ontario Tax Conference, Canadian Tax Foundation for a further discussion in this area.
Probate Planning

In many provinces probate fees are significant.\textsuperscript{72} Given the high cost of probate in many provinces, numerous estate plans involve planning to avoid the incidence of probate costs. For provinces such as Alberta, planning is not required given the low maximum fee unless the individual owns real property in other jurisdictions.

The planning with alter-ego or joint spousal or common-law partner trusts to avoid probate is quite simple. To the extent that assets fall outside of the deceased's estate, no probate fees will be exigible. Accordingly, to the extent that an individual transfers property to an alter-ego trust or to a joint spousal or common-law partner trust, no probate fees will be exigible upon the death of the transferor individual since the property is no longer owned by the individual. This simple planning tool can be very effective in reducing overall costs. In addition, given that the probate process can be complicated and time consuming, reduced legal fees and time should also result from the utilization of alter-ego and joint spousal or common-law partner trusts.\textsuperscript{73}

\textsuperscript{72} For example, the provinces' maximum probate fees are as follows:
- B.C.: 1.4% for estates over $50,000 in value
- Alberta: Maximum charge of $400 for estates over $250,000 in value
- Saskatchewan: 0.7% for all estates
- Manitoba: 0.6% plus $50 for estates with a value of over $10,000
- Ontario: 1.5% for estates over $50,000 in value
- Quebec: nominal fee for holograph/witnessed will, otherwise no charge
- Nova Scotia: $700 and 1.2% for estates over $100,000 in value
- New Brunswick: 0.5% for estates over $20,000
- NWT (including Nunavut): $15 and 0.3% for estates over $1,000
- Newfoundland: $75 plus 0.5%
- P.E.I.: 0.4% for estates over $100,000
- Yukon: $140 for estates over $25,000 in value

\textsuperscript{73} For an excellent discussion on probate planning involving alter-ego and joint spousal or common-law partner trusts see Margaret R. O'Sullivan, \textit{Supra}, footnote 71.
Confidentiality

To the extent that a will is submitted to probate, the will becomes a public document available to anyone who wishes to view it. This may cause concern given that the contents and value of the estate assets are now in the public domain.

However, a trust document such as an alter-ego and joint spousal or common-law partner trust deed is a private document and not subject to public release. For this reason alone, many people are excited that in the context of estate planning confidentiality can now be maintained. This is not achievable if the deceased's assets pass by will and are thus subject to probate.\(^{74}\)

Will Planning / Will Substitutes – Protection Against Estate Litigation / Power of Attorney Replacements

The discussion relating to the above is mainly legal in nature and beyond the scope of this paper. Many great articles have been written on this subject and the author would refer the reader to these papers for a more detailed discussion.\(^{75}\) Given that a trust is a legal relationship, it is unavoidable to not deal with these legal issues when dealing with alter-ego and joint spousal or common-law partner trusts. Accordingly, the selection of appropriate counsel is critical in order to obtain proper advice in these areas.

At a very minimum, the following non-exhaustive list of issues should be considered when dealing with alter-ego and joint spousal or common-law partner trusts:

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\(^{74}\) Again, for a discussion on this issue see Margaret R. O'Sullivan, *Supra*, footnote 71.

1. Are alter-ego and joint spousal or common-law partner trusts better than a will in order to ensure that the wishes of the parties are respected and help avoid the possible application of certain provincial wills variation legislation?  

2. Will the use of an alter-ego or joint spousal or common-law partner trust help to prevent estate litigation and avoid the application of certain family relief legislation for the applicable province?  

3. Is an alter-ego or joint spousal or common-law partner trust preferable to a power of attorney?  

4. Does the use of an alter-ego or joint spousal or common-law partner trust assist in protecting assets from a spouse in the event of a divorce?  

5. Will the transfer of certain assets to an alter-ego or joint spousal or common-law partner trust be considered a fraudulent conveyance?  

6. In many cases, taxpayers may have to deal with the laws of various provinces or perhaps other foreign jurisdictions. The laws of the other provinces or foreign jurisdictions may conflict with that of the home province of the taxpayer. Will the utilization of an alter-ego or joint spousal or common-law partner trust assist in reducing such conflicts?  

7. Can the use of an alter-ego or joint spousal or common-law partner trust provide greater creditor protection than a will?

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76 See Margaret R. O'Sullivan, Supra, footnote 71.  
77 See Stephenson, Supra, footnote 38, for a good discussion on this issue.  
78 See Margaret R. O'Sullivan, Supra, footnote 71 and M. Hoffstein, Supra, footnote 75.  
79 There has been some recent case law in this area in which Alberta Courts have looked at the issue of the value of an interest in a family trust for purposes of the Alberta Matrimonial Property Act. For example, see Kachur v. Kachur 2000 ABQB 709 and Bzdich v. Bzdich 2001 ABQB 306.  
81 For an excellent discussion regarding this topic see Margaret R. O'Sullivan, Supra, footnote 71.
Provincial Rate Shopping

Provincial income tax rates vary widely. Given the large differences in provincial rates, there is often motivation to shift assets or do creative tax planning which will result in taxable income being taxed in the lower rate province.

The use of a trust to provincial rate shop is not a new concept. Given that a trust is taxed as an individual, it would be preferable to have such a trust resident in a lower rate province so as to have the trust's taxable income subject to the lower combined federal and provincial tax rates.

How does a trust become resident in a lower tax rate province? The answer to this question lies in the careful selection of trustees who are resident in the lower rate province since it is the CCRA's administrative position that the trust is resident where the majority of the trustees reside. Case law also seems to support this notion. Accordingly, to the extent that a careful selection of trustees resident in a lower rate province is done, one would assume that the trust's income would be subject to that lower rate of provincial income tax.

82 See, for example, the following table which shows the varying combined federal and provincial income tax rates for interest, dividends and capital gains:

<table>
<thead>
<tr>
<th></th>
<th>YK</th>
<th>NU/NWT</th>
<th>BC</th>
<th>AB</th>
<th>SK</th>
<th>MB</th>
<th>ON</th>
<th>QC</th>
<th>NB</th>
<th>PEI/NS</th>
<th>NF</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Income</td>
<td>45.4</td>
<td>43.5</td>
<td>51.3</td>
<td>43.7</td>
<td>48.2</td>
<td>48.0</td>
<td>47.9</td>
<td>55.4</td>
<td>49.2</td>
<td>48.8</td>
<td>51.3</td>
<td>48.43</td>
</tr>
<tr>
<td>Capital gains*</td>
<td>34.0</td>
<td>32.6</td>
<td>38.5</td>
<td>32.8</td>
<td>36.1</td>
<td>36.0</td>
<td>35.9</td>
<td>41.6</td>
<td>36.9</td>
<td>36.6</td>
<td>38.5</td>
<td>36.32</td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>29.0</td>
<td>28.4</td>
<td>32.2</td>
<td>24.1</td>
<td>29.6</td>
<td>34.0</td>
<td>31.3</td>
<td>33.4</td>
<td>31.4</td>
<td>32.0</td>
<td>32.9</td>
<td>31.46</td>
</tr>
<tr>
<td>Capital gains</td>
<td>21.5</td>
<td>21.0</td>
<td>22.8</td>
<td>19.5</td>
<td>22.5</td>
<td>23.2</td>
<td>23.2</td>
<td>23.4</td>
<td>23.4</td>
<td>23.7</td>
<td>24.3</td>
<td>23.85</td>
</tr>
<tr>
<td>Interest Income</td>
<td>43.0</td>
<td>42.0</td>
<td>45.7</td>
<td>39.0</td>
<td>45.0</td>
<td>46.5</td>
<td>46.4</td>
<td>48.7</td>
<td>46.8</td>
<td>47.4</td>
<td>48.6</td>
<td>45.75</td>
</tr>
</tbody>
</table>

*Calculated at 75% rate

83 See subsection 104(2).
85 Thibodeau Family Trust v. The Queen 78 DTC 6376.
However, it is not that simple. Other issues need to be considered. Some of the other issues that need to be considered are as follows:

1. Would such provincial rate shopping be subject to the home province's provincial general anti-avoidance rule?\(^{86}\)
2. Provincial rate shopping will require out-of-province trustees. Are these trustees reliable and trustworthy? Are they available on a timely basis in order to make decisions of the trust on an ongoing basis?
3. Will provincial rate shopping add significant extra compliance costs which will reduce the overall tax benefit?
4. Can the out-of-province trustees be easily replaced?
5. Ensure that subsection 75(2) of the Act is not applicable so as to ensure the desired result is being achieved.

**Life Insurance Planning**

Given that an overall estate plan for individuals often times will involve the utilization of life insurance products to provide liquidity, pay testamentary debts, build up capital in a tax efficient manner, et cetera, the obvious question that will arise in the future will be how such life insurance products should be held. Will it make sense for an alter-ego or joint spousal or common-law partner trust to be the owner and/or beneficiary of such a policy? Will "shared ownership" applications involving an alter-ego or joint spousal

\(^{86}\) Many provinces have provincial general anti-avoidance rules which try to prevent avoidance transactions to the extent that the transactions provide a provincial tax benefit. Accordingly, provincial rate shopping should only be done in the context of an entire estate plan and hopefully be supported by other factors other than just simply tax reduction.
or common-law partner trust make sense? The answer to these questions will be fact-dependent, but nevertheless practitioners should be aware of planning opportunities in this area.

Subsection 47(1) Planning – Avoidance of the Cost Averaging Rule

Subsection 47(1) requires taxpayers who hold identical properties to average their cost base. This can sometimes accelerate the instance of income tax when a taxpayer holds a pool of properties with a low cost base, but has acquired other properties that are identical at a higher cost base. The averaging of the cost bases of these two or more pools may often times drive down the overall cost base of an identical property which will result in a larger capital gain that would otherwise have been realized had the higher cost base pool been disposed of separately and without the incidence of subsection 47(1). This was a common problem with the use of stock options. For example, to the extent that Mr. Apple held 1M shares of "Pubco" in 1999 with a cost base in the aggregate of $1 and he exercised 1,000 options of Pubco with an exercise price of $10 per share and immediately sold such shares for a price of $20 per share, the resulting capital gain would be $19,980. However, with stock options, new rules under subsection 47(3) will often times now prevent such a result from happening and treat the option shares as a separate pool.

\[\text{Proceeds} \quad \text{ACB} \quad \text{Capital Gain}]
\[
\begin{array}{ccc}
\text{Shares} & \text{Number} & \text{ACB}\$
\end{array}
\]
\[
\begin{array}{ccc}
1) & 1,000,000 & 1
2) & 1,000 & 10,000
3) & - & 10,000
\end{array}
\]
\[
\text{Total} \quad 1,001,000 \quad 20,001
\]


88 The capital gain is computed as follows:

\[
\begin{array}{c}
\text{Proceeds} \\
\text{ACB} \\
\text{Capital Gain}
\end{array}
\]
\[
\begin{array}{c}
$20,000 \\
20 \\
19,980
\end{array}
\]

89 New subsection 47(3) of the Act was introduced as part of the new stock option deferral rules under subsections 7(8) to (16). In addition, subsection 7(1.3) and (1.31) are also applicable.
For any other property that is not a stock option, subsection 47(1) will continue to apply to require the taxpayer to average his cost base. The use of an alter-ego or joint spousal or common-law partner trust may avoid the cost base averaging rules. This is true since the lower cost base property which the taxpayer may seek to not have averaged with higher cost base property could be transferred on a tax-deferred basis\(^90\) to an alter-ego or joint spousal or common-law partner trust prior to acquiring the higher cost base property. Such property could then be disposed of either in the new trust or in the other taxpayer's hands, depending on which situation is better. Careful planning would need to be done in this area to ensure that the desired result is being achieved.

E. **AN EXAMPLE CASE STUDY**

In order to highlight some of the planning opportunities with an alter-ego or joint spousal or common-law partner trust, we will now consider the situation of the "Plan" family. Let us consider the following facts and objectives for the Plan family.

**Facts**

1. Mr. Plan is a Canadian resident and 68 years of age. Mr. Plan resides in Big River, Saskatchewan.
2. Mr. Plan is married to Mrs. Plan who is also a Canadian resident for income tax purposes and is 67 years of age. This is the first marriage for Mr. Plan and the second marriage for Mrs. Plan. Mr. and Mrs. Plan have been married for 20 years.
3. Mr. and Mrs. Plan have no children from their marriage, but Mrs. Plan has three children from her previous marriage. All of Mrs. Plan's children are over the age of 18 years.

\(^90\) If the conditions under section 73 are met.
4. It would appear that Mrs. Plan's children were not very happy with her decision to marry Mr. Plan 20 years ago. Accordingly, the relationship amongst Mrs. Plan's children and Mr. Plan has been tenuous at best.

5. Mr. Plan owns the following relevant assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>FMV</th>
<th>ACB</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Marketable Securities</td>
<td>$2,000,000</td>
<td>$1,300,000</td>
</tr>
<tr>
<td>(b) Shares of &quot;Opco&quot;</td>
<td>10,000,000</td>
<td>1</td>
</tr>
<tr>
<td>(c) Cash</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>(d) Principal Residence</td>
<td>1,000,000</td>
<td>450,000</td>
</tr>
<tr>
<td>(e) Cottage</td>
<td>550,000</td>
<td>350,000</td>
</tr>
</tbody>
</table>

6. Mrs. Plan's assets are minimal.

7. Opco is a Canadian corporation\textsuperscript{91} whose principal business is the manufacturing of slippers. It is extremely profitable.

8. Due to the profit of Opco and the lifestyle requirements for Mr. and Mrs. Plan, Mr. and Mrs. Plan draw significant income in the form of either salary or dividends from Opco. Accordingly, both Mr. and Mrs. Plan are at the highest marginal personal income tax rates.

9. Mr. and Mrs. Plan are very philanthropic and have a deep desire to donate a significant amount of their estate to their church in Big River, Saskatchewan upon their last death.

**Objectives**

Mr. and Mrs. Plan have come to you with the following objectives:

a) To prevent any possibility of Mrs. Plan's children from obtaining the assets of Mr. Plan both upon the death of Mr. or Mrs. Plan or upon the incapacity of Mr. or Mrs. Plan.

b) Mr. and Mrs. Plan would like to reduce the possibility of estate litigation upon their deaths.

\textsuperscript{91} As defined under subsection 89(1).
c) Mr. and Mrs. Plan are interested in saving income tax currently and upon their eventual last death.

d) Mr. and Mrs. Plan would like to ensure that their philanthropic objectives are met by donating the residual of their estate upon the last death of Mr. and Mrs. Plan.

e) Mr. and Mrs. Plan would like to reduce the cost of probate upon their eventual passing.

Possible Planning Alternatives

Mr. and Mrs. Plan decided to visit their tax accountant and trust lawyer. The advisors reviewed their list of objectives and focused in on their desire to protect assets from Mrs. Plan's children and ensure that their wishes were carried out both during lifetime and upon death. After reviewing applicable law in Saskatchewan, the lawyer suggested that a joint spousal or common-law partner trust may have certain advantages over a will and a power of attorney. The lawyer also informed Mr. and Mrs. Plan that the use of a joint spousal or common-law partner trust can help reduce probate costs upon death. Given these advantages, Mr. and Mrs. Plan were very interested in the possible utilization of a joint spousal or common-law partner trust in their estate planning.

The tax accountant then explained to Mr. Plan that certain income tax advantages can also be had with the utilization of an Alberta joint spousal or common-law partner trust to take advantage of provincial rate shopping. However, the disadvantage of such a plan would be that Mr. Plan would not be able to be a capital beneficiary of the trust. Mr. Plan is not sure whether or not he would like this and, therefore, he needs time to think about it. However, he does inform the lawyer that to the extent that he had other assets that could be set aside for his own use during the remainder of his lifetime he would be more comfortable not being a capital beneficiary of such a trust. Accordingly, the trust lawyer and tax accountant suggested the following plan for Mr. and Mrs. Plan:
1. Have an Alberta lawyer draft a joint spousal or common-law partner trust deed whereby Mr. Plan would not be a capital beneficiary.\footnote{Of course the majority of the trustees of the joint spousal or common-law partner trust would need to be Alberta residents. Therefore, Mr. and Mrs. Plan would need to carefully think about who they would like to appoint as trustworthy people to fulfill the role of trustees.} The Alberta lawyer would, of course, ensure that the trust is properly settled.

2. Mr. Plan would then exchange his common shares of Opco for redeemable, retractable preferred shares of Opco that would have a redemption value of $10M.\footnote{Such an exchange of shares by Mr. Plan is commonly known as an estate freeze and would be completed on a tax deferred basis utilizing subsection 85(1), 86(1) or 51(1). However, it is likely that subsection 85(1) is the provision of choice given that Mr. Plan will likely want to "bump" his adjusted cost base of the preferred shares of Opco by utilizing his available capital gains deduction under subsection 110.6(2.1).} Assuming that the shares of Opco are qualified small business corporation shares,\footnote{As defined under subsection 110.6(1).} Mr. Plan would trigger a capital gain of $500,000 (or his otherwise available capital gains deduction) so as to fully utilize his available capital gains deduction on such shares.\footnote{The capital gains deduction on qualified small business corporation shares is available pursuant to subsection 110.6(2.1).}

3. Given Mr. Plan's reluctance to be excluded as a capital beneficiary of the joint spousal or common-law partner trust, Mr. Plan would then decide how much of the $10M redeemable, retractable preferred shares of Opco that he would like to transfer to the joint spousal or common-law partner trust on a tax-deferred basis.\footnote{Pursuant to the rules as outlined in section 73.}

4. Once such a decision has been made, legal counsel would effect a transfer of the appropriate number of preferred shares to the joint spousal or common-law partner trust.

5. The Alberta trust lawyer would draft a non-joint spousal \textit{inter-vivos} discretionary trust with Mr. and Mrs. Plan and their church as income and capital beneficiaries. The trustees would then arrange to acquire new common shares of Opco, utilizing its own funds, for a nominal subscription amount. Such a subscription by the trust will allow the future growth of Opco to accrue to the trust. The trustees of the trust would be Alberta residents.
6. Mr. Plan would then need to decide how much of the marketable security portfolio he would feel comfortable transferring to the trust if he was not a capital beneficiary. Once such a decision is made, the balance of the portfolio that Mr. Plan would feel comfortable transferring would be so transferred to the trust. Accordingly, legal counsel would effect such a transfer and the transfer would occur on a tax-deferred basis.\footnote{Pursuant to the rollover rules in section 73.}

Now that a joint spousal or common-law partner trust holds the majority of the Plan family’s assets, one must consider future planning. For example, should the house or cottage be transferred to the trust as well, given that the Act provides for a significant advantage in the ownership of principal residential properties?\footnote{One will have to consider this issue very carefully. See the principal residence exemption in paragraph 40(2)(b) of the Act.} Not enough information is given in the facts to determine this issue with accuracy. For example, how long has each property been held, were the properties acquired prior to 1981, how much land does each property reside on? The answers to each of these questions will determine how the principal residence exemption should be maximized. Will a transfer of the property to the trust compromise such utilization of the principal residence exemption? In many cases the answer to this question is yes.\footnote{See Stephenson, \textit{Supra}, footnote 38.} Accordingly, other planning with respect to the principal residence and cottage properties such as perhaps transferring the properties into joint tenancy should be considered. In addition, GST issues and municipal and provincial land transfer taxes, if any, should be considered to the extent that such properties were to be transferred to the trust.\footnote{For example, to the extent that the cottage or principal residence resided on property in excess of one-half a hectare and the excess was not considered necessary for the use and enjoyment of that property, the transfer by the Plans of the applicable property to the trust may trigger unavoidable GST consequences. Caution!}

To the extent that Mr. and Mrs. Plan wish to carry out their philanthropic objectives, a detailed charitable gifting plan should be put in place. As stated in the body of the paper, one will have to carefully consider whether or not such charitable gifting activities would be preferable from the individual’s estate or from
the use of a joint spousal or common-law partner trust. Would a charitable remainder trust have a place in the Plan's philanthropic planning? In the present case it is likely that a combination of options would be utilized. Accordingly, a mathematical analysis of how exactly such a plan should be carried out would need to be done. Would the use of a life insurance policy to carry out the philanthropic objectives of the Plans be appropriate? Perhaps. From a tax perspective and as stated in the body of the paper, to the extent that assets are gifted from the capital of the joint spousal or common-law partner trust, one will have to be careful of the desired tax results. For example, will it be desirable for the trust to have a charitable tax credit or would it be desirable to have the trust reduce its income by taking a deduction pursuant to subsection 104(6)?

Given that both trusts will likely have been drafted to avoid the application of subsection 75(2), the trusts could be utilized for provincial rate shopping on an ongoing basis by having such taxable income of the trust taxable at Alberta tax rates. The resulting net after-tax capital would be added to the capital of the trust and thus available for distribution to Mrs. Plan to the extent that the Plan family needs additional monies. The joint spousal trust could realize ongoing income by generating investment income on its marketable security portfolio or by having the directors of Opco declare dividends on the common shares that the joint spousal trust would hold. Of course, the declaration of dividends would need to be done on the common shares held by the non-joint spousal trust so as to avoid the application of the attribution rules in order to avoid having such dividend income taxed in Mr. Plan's hands.

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101 A charitable remainder trust is not defined in the Act. For the CCRA's administrative comments, please refer to Interpretation Bulletin IT-226R “Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust” dated November 29, 1991.

102 Pursuant to subsection 118.1(3).

103 To the extent that it would be desirable to have the trust take a deduction pursuant to subsection 104(6), it is likely that the trust would need to have the charity as an income beneficiary.

104 Under subsection 74.1(1) in conjunction with subsection 74.3(1) unless a designation under subsection 104(13.1) was made by the trust.

105 In addition, one would have to ensure that Opco would continue to be a small business corporation as defined under subsection 248(1) so as to avoid the application of the corporate attribution rule under subsection 74.4(2).
Upon the last death of Mr. and Mrs. Plan, the joint spousal trust will be deemed to have disposed of its assets at fair market value.\textsuperscript{106} Given that the joint spousal is an \textit{inter-vivos} trust, all such resulting capital gains would be taxed at the highest marginal tax rate. In some cases, as discussed in the body of the paper, this can be a disadvantage since the otherwise resulting capital gains could have been subject to tax in the deceased's terminal return at progressive tax rates. This is unlikely in the present case since Mr. and Mrs. Plan would likely always be at the highest marginal tax rate, thus not causing a significant disadvantage.

In addition, the disposition of the trust assets will not be subject to probate given that the assets are not within the estate of either of Mr. or Mrs. Plan. This will have saved Mr. and Mrs. Plan 0.7\% of the value of the trust’s assets.

As you can see, most of the objectives of Mr. and Mrs. Plan will likely have been met. However, a more detailed cost vs. benefit with mathematical and legal analysis needs to be done to ensure that the benefits exceed the costs of utilizing a joint spousal trust to carry out the estate planning objectives of Mr. and Mrs. Plan.

\textbf{F. CONCLUSION}

The introduction of alter-ego and joint spousal or common-law partner trusts in Canadian tax legislation opens the floodgates for very effective and creative estate planning for clients. Clients will likely appreciate the opportunity to know of the possibilities surrounding this new legislation.

\textsuperscript{106} See paragraph 104(4)(c).