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Tax, Retirement & Estate Planning Services

Investment Insight

Joint tenants with rights of survivorship - An appropriate strategy?

Why the interest in this arrangement?

A joint ownership arrangement with a right of survivorship (joint tenancy) is often used as part of estate planning. Legal title of an asset(s) (e.g. real property) changes while the owner is alive to a joint ownership arrangement often times to avoid probate. It may also be seen as a way to deal with future incapacity issues or to assist an elderly person (most likely a parent) with managing their assets while they are still alive. While thought to be a simple solution to address these needs, recent case law has indicated otherwise. The law of joint ownership arrangements has evolved and entering into this type of ownership should be considered carefully.

What is joint ownership?

Generally, there are two ways in which to own property: tenants in common or joint tenancy.

Tenants in common

Tenants in common is a form of ownership whereby each owner holds an undivided interest in property. The interest of a tenant in common does not terminate upon his or her death. Each owner in this arrangement has a separate and distinct title to their interest in the property. For example, if A and B own property as tenants in common and A dies, A's interest will form part of A's estate and will be distributed in accordance with A's will (presuming a will exists).

Joint tenancy

Joint tenants have one and the same interest in property. Upon the death of one of the owners, there is a right of survivorship in the interest of the other owner. The interest of the deceased owner does not pass through their estate and is therefore not distributed through their will. For example, if A and B own property as joint tenants, on the death of A, A's interest in the property will revert to B by right of survivorship. This will occur if A's interest has rights in both the legal and beneficial ownership of the property which is discussed in more detail below.

Because the interest of the deceased owner does not flow through their estate that interest is not subject to probate or creditors of the estate. This may be appealing in provinces where probate fees are high. It also means that challenges to the will are avoided and costly delays prevented.

Joint ownership has distinguishing components to it that divides up rights into legal ownership and beneficial ownership.

- What is legal ownership?
  Legal title to an asset or property is held by an individual. That individual may also enjoy beneficial interest to the property or they may simply hold legal title. If legal title is held and beneficial ownership belongs to another individual the legal title holder will have fiduciary obligations to the beneficial owner in relation to holding that property.

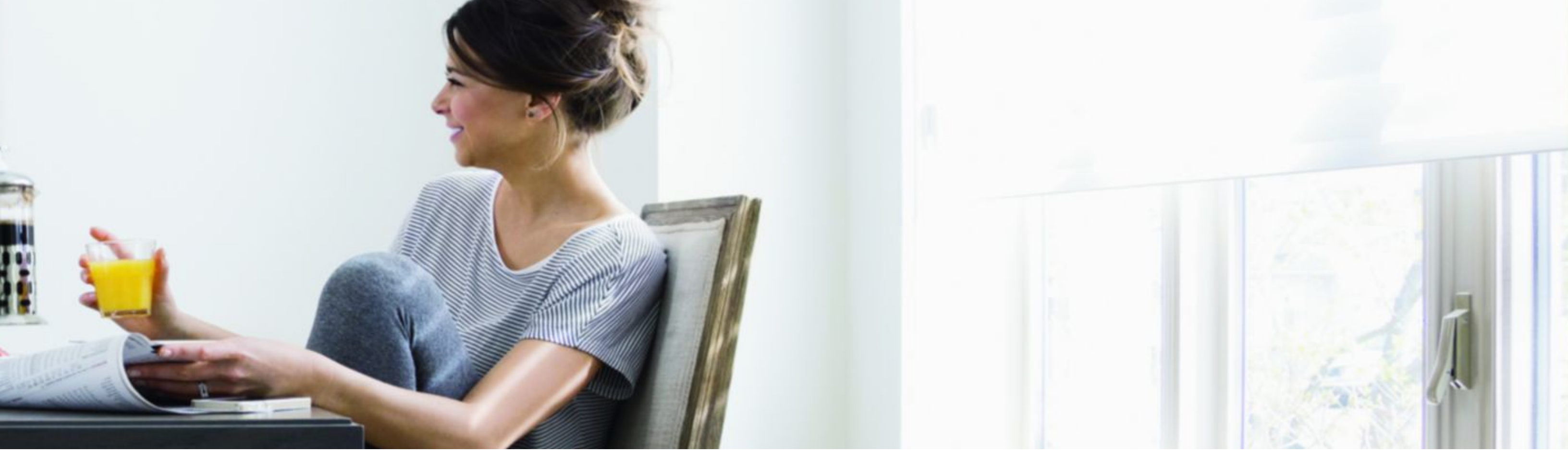
- What is beneficial ownership?
  Beneficial ownership arises where one party holds legal title to property, but another party has rights attached to that property. The property is held to the latter's benefit with fiduciary obligations existing for the legal title holder to the beneficial owner.

Where an individual owns both legal and beneficial ownership of property, this distinction becomes less relevant to the discussion.

The evolution of case law

Two Supreme Court of Canada ("SCC") decisions from 2007 have significantly impacted the thinking behind joint tenancy strategies. In both Pecore v. Pecore, 2007 SCC 17 and Madsen Estate v. Saylor, 2007 SCC 18 a father put bank and investment accounts into joint names with an adult daughter.

Both transfers were gratuitous (that is, for no consideration). In both cases certain other parties contended that the assets should form part of the deceased's estate and should not have passed to the daughter via a right of survivorship. When the transferor's intent is unavailable or not clear the court applies two legal principles to assist it in making a determination. They are: the presumption of advancement and the presumption of resulting trust.



Where an individual transfers an asset or property into the name of another person or into the name of himself or herself together with another person, a resulting trust is presumed in his or her favour. The presumption may be rebutted by evidence of an intention to make a gift of the interest in the asset or property. A presumption of resulting trust applies to gratuitous transfers. In Pecore the court indicated that a resulting trust arises when title to property is transferred or given for no value. When this happens, the onus is placed on the transferee to demonstrate that a gift was intended.

The Court applies the presumption of advancement where gratuitous transfers are made by parents to minor children. In 1957, the SCC applied the principle that fathers (not mothers) will make gifts to their children to fulfill their obligation of support.

If a father deposited money into an account held jointly with his child, then the court presumed that the father intended to give a gift. The presumption does not apply where the transfer is made to an adult child and, therefore, could not be applied in the Pecore case. Where property has been transferred into a joint tenancy arrangement with a spouse (including common law and same-sex couples) or near relative (e.g. niece or nephew), the transfer is considered to be an advance because it is presumed that it was intended as an advancement arising from a moral obligation or as a token of affection.

In the Madsen estate case the SCC examined the bank and investment accounts. Both carried the right of survivorship designation but did not have an expressed reference to a beneficial interest in the accounts. The SCC said evidence of joint ownership includes not only legal title, but also beneficial title to an asset so that each party may use and benefit from the ownership arrangement.

What has flowed from these two cases is that the intention to own property jointly must be considered carefully from the evidence presented. The Court will consider the actions of the transferor, the types of documents that have been signed, who has contributed to the accounts and how the accounts are being used and for what purpose. Such evidence will assist the Court in determining the intention of the transferor.

These two SCC cases establish that the use of joint tenancy strategies between an aging parent and an adult child may well be problematic.

Joint tenancy considerations

In addition to the case law illustrating the complexity of such arrangements, many other factors need to be considered before property is transferred into joint tenancy. The decision to embark on such a transfer should not be made lightly. Factors that need to be assessed include:

- Income tax implications
- Loss of control over assets
- Exposing assets to creditors including family law disputes
- Capacity issues
- Inappropriate estate distribution
- Probate

It goes without saying that the appropriate legal advice should be obtained. Individuals will want to be sure that their wealth is transferred to the desired party. Litigation can be protracted and costly, especially when the property becomes part of a dispute amongst family members or where divorcing spouses contend that the asset forms part of family property.

Income tax implications

Joint tenancy transfers have both legal and tax considerations. From a tax perspective the following questions arise:
(1) Was there a disposition for tax purposes?
(2) How should the income from the property be reported on a go-forward basis?

Disposition

The definition of "disposition" in the Income Tax Act ("ITA") does not include a transfer of property where there is no change in the beneficial ownership of the property except in respect of certain transfers to and from a trust. In Pecore, the SCC indicated that the beneficial owner of the property is described as the real owner even though the property is in someone else's name.

The CRA in IT 2015-058053 dated June 19, 2015 indicated that ownership is not a matter of income tax legislation interpretation but rather requires a legal determination of property ownership. Income tax consequences arising from the deemed disposition of property upon the death of an individual will only occur where the deceased had legal and beneficial ownership of that property.

Where an entire property belonged to a parent and a child has no rights of beneficial ownership, 100 percent of the property would be deemed to be disposed of at fair market value on the date of the parent's death. Any gain or loss from that deemed disposition would be reported on the final return of the deceased. The estate would then be deemed to have acquired this property at fair market value. Any subsequent gain or loss realized shortly thereafter from the actual disposition of the property held by the estate would be reported by the trustee in the T3 return of the estate. Proceeds from the sale of property, along with any other property held by the estate would be distributed in accordance with the will of the deceased after the payment of debts of the estate including any taxes.

If, however, the child is a legal and beneficial owner of a portion of this property then only the portion that the parent owned would be deemed to be disposed of on the date of death of the parent, with any gain or loss on the portion that was owned by the deceased parent reported on their final T1 return. Upon a subsequent disposition of the entire property the T1 return would indicate any gain or loss on the portion of the property that the child was legal and beneficial owner of at the time of disposition.

In summary, the CRA indicates that the ownership of the property at the date of the parent's death must be determined before the tax consequences of any deemed or actual disposition of property can be ascertained.

CRA has long accepted that it is possible to have a change in legal ownership (legal title) without there being a disposition for tax purposes.

Thus, the intent of the parties will have to be established (and documented) when there is a transfer to joint tenancy. The evidence that captures intent will impact the tax treatment of the joint tenancy arrangement. If there is in fact a disposition of the beneficial ownership of a capital asset, capital gains implications will have to be considered.

Income attribution considerations

Whenever there is a disposition of a beneficial interest, the income attribution rules still need to be considered. There are rules under the ITA that come into play when there are transfers to a spouse and minor children. When assets are loaned or transferred (either directly or indirectly) to a spouse, or a person who has subsequently become a spouse, specific rules in the ITA provide that the transferor must still report the income from the property, as well as any capital gain or loss from the sale of the property. (See subsection 74.1 of the ITA) Common-law spouses (including same-sex spouses) are considered "spouses" for the purposes of these rules.

Similar rules apply where property is transferred to a minor child, except that capital gains or losses are not attributed back. The rules apply in taxation years in which the child has not attained age 18 by the end of the year. A "minor" includes someone who does not deal with the transferor at arm's length, as well as nieces and nephews (See subsection 74.2 of the ITA). Under the ITA, "related" persons do not deal at arm's length. This group includes: a child, grandchild, great-grandchild (including a spouse's child, a child's spouse), brother or sister (or brother- or sister-in-law). All of these relationships include those that exist within common-law and same-sex relationships.

Taxpayers may mistakenly believe that income splitting can be achieved by transfers of assets into joint ownership. The Canadian tax system is one of self-assessment, and a taxpayer must report their income appropriately. Having two names on a T3 or T5 slip does not mean that the splitting of income is legitimate.

Loss of control

When creating a joint tenancy arrangement of ownership of an asset a major issue that needs to be considered is possible loss of control. There are situations where the transferor may have a falling out with the transferee and may want to ask for the asset back. The transferee would need to consent to this. The transferee has the legal right to refuse to consent to transferring ownership back.

Remember also that in many situations the asset cannot be sold without the consent of both parties. Legal advice would also have to be sought whether, for instance, it is possible to sever a joint tenancy and convert it to a tenant in common arrangement. The Ontario Court of Appeal in Hansen Estate v. Hansen, 2012 ONCA 112 (CanLII) did address this scenario and the facts in that case allowed the court to find in favour of a tenants in common arrangement and not a joint tenancy.

Also, consent to mortgaging or pledging the asset must be obtained by all joint owners. Any decisions regarding jointly held investments and the nature of those investments must be agreed upon by all of the joint owners.

Exposing assets to creditors including family law claims

An asset held as joint tenants is exposed to the debts of all of the joint tenants. If, for example, one of the joint owners was responsible for damages from an accident, the asset would be at risk.

Remember too that approximately 41 per cent[1] of marriages end in divorce. Where joint assets become part of family law act claims an ex-spouse may have a claim on the asset held jointly with a third party. Joint tenancy arrangements expose the asset to the claims of a spouse. A good example is where a child becomes a joint tenant of a valuable asset such as a cottage and their ex-spouse makes a claim that includes the cottage in the family law dispute.

Extreme care should be taken in documenting the transferor's intention when there is a transfer into joint tenancy. In some common law jurisdictions if there is documented proof that the intention of the transferor was to "gift" the property, then it may be excluded under family law legislation.

For all of these reasons, it is extremely important to seek legal advice to determine the impact other relevant laws may have on a transfer into joint tenancy.

[1] Statistics Canada - Divorce http://www.statcan.gc.ca/eng/help/bb/info/divorce

Capacity

When joint owners have capacity, decisions regarding jointly held property are made together. However, when an owner becomes incapacitated the other owner may be left in a position where they cannot make decisions regarding the asset. If an Attorney is appointed under a Power of Attorney (POA) document to deal with the asset, then the other owner will make decisions with the named attorney. This may work fine if the parties think the same but where this is not the case, disputes may arise.

Where no POA exists, the other owner may be moved to seek court appointment as an attorney in order to be able to deal with the asset.

Inappropriate Estate Distribution

Individuals usually try to determine before death how they want their wealth distributed. A will is used to distribute assets. Wills also deal with taxes and debts of the estate. Liability for tax owing by the estate is contemplated in the distribution in the will. However, when assets flow outside of the estate the tax liability may still fall to the estate. As a result, the beneficiaries under the will may receive less due to the estate paying the tax first and then making the distribution. For those who receive the assets by way of joint tenancy, they receive the asset without the associated tax burden. The outcome may mean that the joint tenancy owner receives a greater portion of the overall estate which may not have been the testator's intention.

Probate

All of the common law provinces levy probate fees, with some charging higher rates than others.

Taxpayers may go to considerable lengths to avoid these fees including using joint tenancy arrangements. This is sometimes the case regardless of the several issues that must be considered. Caution should be noted about joint tenancy arrangements to avoid probate. While avoiding probate fees may be accomplished, other issues may arise which far outweigh the benefit of actually paying the applicable probate fees of the province.

Each province's provincial legislation employs its own means in which to determine the "value of the estate" for probate purposes. The probate regime in Ontario has changed leading to further analysis as to what the intent of the transferor truly was when entering into a joint tenancy arrangement.

The Ontario Estate Administration Tax Act (1998, SO 1998 c. 34, Sch) ("EATA") sets out regulations which were amended and became effective January 1, 2015. The Estate Information Return ("EIR") and Guide indicates that assets that are beneficially owned by the deceased, even though legal title resides in another person, must be included in the EIR.

The accompanying Guide refers to joint bank accounts where "the deceased's estate continues on as an owner" as having to be included. There are also other references in the Guide that require that assets which the deceased had a beneficial interest in be disclosed.

As previously discussed the legal principles in the Pecore decision indicate that certain assets which are held joint with right of survivorship between a parent and an adult child are presumed to be beneficially owned by the parent by way of a resulting trust. To rebut this presumption there must be evidence that indicates that the transfer was intended to be a gift.

For the Estate Trustee this presents a bit of a conundrum. At this point, the Ontario Ministry of Finance will apply the presumption of resulting trust to transfers between a parent and an adult child and may challenge such joint tenancy arrangements as a result. If the Ministry argues successfully that a resulting trust existed, probate fees will apply. Therefore, it is important to ensure that good evidence exists as to the intent of the transferor at the time of entering into the joint tenancy arrangement.

Use of designations in insurance products

Both Pecore and Madsen Estate and the cases that have followed illustrate the problems that arise with joint ownership strategies if not well documented.

Now more than ever designations in insurance products provide a very attractive alternative to a joint tenancy arrangement. Designations in insurance products (including Guaranteed Investment Certificates (GICs) issued by insurance companies, payout annuity products, segregated fund products, and life insurance products) are a method that many individuals should be using instead of transferring financial assets. The heirs will receive their bequests considerably more quickly than would be the case where assets are being distributed under a will. In addition to savings in probate fees and other costs associated with administering an estate (legal fees, accounting fees, etc.), insurance products may offer other advantages (death benefit and maturity guarantees for segregated fund products, creditor protection).

A qualified estate planner can provide advice on the appropriate use of a number of other strategies including trusts, beneficiary designations for insurance products, annuity settlement options that may be available for payouts under insurance products, gifts prior to death, etc.

Summary

A client will have spent his or her entire lifetime accumulating wealth and will have specific desires as to how this wealth is to be disbursed upon his or her death. Estate planning should ensure that this objective is met.

As we have outlined above, a number of factors need to be assessed before assets are transferred into joint tenancy. This is a commonly used technique and may be appropriate in certain circumstances. However, alternative methods should be assessed. Advisors should urge their clients to seek the appropriate legal advice. This will ensure clients are entering into this ownership arrangement with the proper knowledge to determine if this planning best meets their needs.

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