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COMMENT

Number 244 – JULY / AUGUST 2007

JOINT ACCOUNTS

Many couples use the strategy of placing assets in joint title as a means to complete elements of their estate plan. The idea is to transfer ownership of assets by right of survivorship rather than having the assets pass through the estate and then on to the beneficiary. An asset registered in joint tenancy will pass to the surviving owner(s) upon the death of either owner. A parent might add a child as a joint owner on title of an asset so that the asset would pass directly to that child upon the parent's death.

It should be noted that assets registered in tenancy in common, another form of joint ownership, give each owner an interest that can be sold or bequeathed by each owner. As a result, the ownership interest in a property held in tenancy in common will not pass automatically to the other joint tenants on the death of one of them. (Note also that these concepts of joint ownership are applicable only in the common-law provinces and do not apply under Quebec's civil code concept of "co-property.")

The reasons for the joint title strategy might include some or all of the following:

1) avoid probate fees, which are provincial government fees levied on the assets of an estate;
2) achieve a certain level of privacy because assets passing through an estate become a public record, whereas assets passing as a right of survivorship will not be listed in the probated estate;
3) simplify the estate plan because assets passing as a right of survivorship are not included in the estate and pass automatically to the survivor; and
4) control estate expenses because many estate charges are levied on the assets passing through the estate.

It should be noted that putting an asset into joint title does not avoid any income tax implication and, in fact, could accelerate it. The parent would be taxable on any realized capital gain triggered by the transfer of title into joint ownership.

A portion of the accrued gain could be realized when the asset is first put into joint title depending on the intentions of the parent. If Canada Revenue Agency (CRA) can demonstrate that the intention was to immediately pass the right of ownership to the child by providing a beneficial interest, then the parent will be considered to have disposed of half of the property and will be subject to tax on half of the accrued capital gain.

The parent will be deemed to have disposed of his or her remaining interest upon death when the property finally passes fully into the child's name.

It is important to understand that the use of joint titles is not without risk. The primary issue is whether the asset passing under the right of survivorship should be part of the parent's estate (on a notional basis) in terms of the division of the estate. Consider the example of a parent who puts a $100,000 term deposit into joint title

with his daughter and leaves a $150,000 stock portfolio in his estate, which is to be divided equally between his son and daughter. Should the daughter inherit $175,000 (i.e., $100,000 plus half of the $150,000 stock portfolio) or $125,000 (i.e., half of the $100,000 term deposit and half of the $150,000 stock portfolio)?

This issue was tested in two recent decisions by the Supreme Court of Canada, where the outcome went both ways, based on the facts specific to each situation.

In Pecore v. Pecore, the father placed the bulk of his assets into joint accounts with his daughter. In his will, he left the residue of his estate equally to his daughter and son-in-law, with no mention of the joint account. The Supreme Court held that based on the evidence presented, it was the father's intentions that the title change was a gift that would transfer to the daughter alone upon his death.

The Supreme Court used this case as an opportunity to address the competing common-law issues of a *presumption of advancement* and a *presumption of resulting trust*. When a transfer to joint title is made from a parent to a child, is the parent attempting to benefit the child and to have the assets pass directly to the child outside of his or her will upon his or her death (*presumption of advancement*)? Alternatively, is the transfer an advance to his estate where the parent intended the child to hold the asset in trust (*presumption of resulting trust*)? The court held that the presumption of resulting trust should be the general rule except where the transfer is to a dependent child who is not an adult, in which case the presumption of advancement should hold. The court's guideline suggests that the assessment will be based on the evidence, where sufficient evidence exists. If challenged, the onus to prove the transferor's (i.e., parent who transferred title) intentions falls to the transferee (i.e., child with whom title was shared), particularly if the transferor is deceased.

In Madsen Estate v. Saylor, the father opened a joint bank account with one of his children. Upon the father's passing, his will instructed his estate executor to divide the residue equally amongst his children. The Supreme Court held that based on the facts of this situation, the daughter received the money in a resulting trust and the bank accounts that were placed in joint title were to form part of his estate with respect to the division among his children.

Based on these Supreme Court decisions, the documents completed when moving assets into joint title can become a consideration when assessing the issue of beneficial entitlement, as the documents may address the issue specifically in their wording. Specific circumstances and the ability to demonstrate the transferor's intention become important issues when a joint title asset is challenged. The simple existence of a joint title asset passed from a parent to a child is no longer sufficient to ensure the right of survivorship, as there is now strong precedent to support alternative results.

Putting assets into joint names may be part of an estate plan, but it is advisable to specifically acknowledge whether the assets held in joint title are to be eventually divided among the testator's beneficiaries.

I/R 2500.04, 2121.00

PENSION SPLITTING

On October 31, 2006, Finance Minister Jim Flaherty announced his Tax Fairness Plan, which included a proposal for pensioners to split their pension income with their spouses.

Splitting pension income will allow many couples to reduce their overall income tax liability and thereby increase their after-tax cash flow. Income taxes may be saved in a number of ways because of this new opportunity.

1) By shifting income from the spouse in a higher marginal tax bracket to the spouse with a lower marginal tax bracket, less tax will be paid on the same total income.
2) Where one spouse may be exposed to the Old Age Security clawback, shifting income could enable the spouse to reduce or avoid the clawback.
3) Where the Old Age Security clawback is triggered for both spouses, shifting income could provide the opportunity to expose only one spouse to the clawback rather than both spouses.
4) Income may be shifted from the spouse who is exposed to the clawback associated with the federal age amount credit ($5,177 for 2007).

5) Income splitting will allow both spouses to fully utilize the pension income credit.

The rules allow a *"pensioner"* to shift as much as 50 per cent of *"eligible pension income"* to the *"pension transferee."* A *pensioner* is defined as someone in receipt of eligible pension income. It should be noted that there is no age requirement imposed on the pensioner. *Eligible pension income* is defined as income qualifying for the $2,000 federal pension income tax credit. A *pension transferee* is defined as a person married to the pensioner or in a common-law relationship with the pensioner.

The pension split will be an annual election signed by both people, filed with their personal tax returns. The maximum amount that can be shifted is defined as follows:

50 per cent of A times B divided by C where:

- A is the pensioner's eligible pension income for the year;
- B is the number of months in the year that the couple was married or in a common-law relationship; and
- C is the number of months in the pensioner's taxation year, which may be less than 12 if the pensioner had passed away in the year.

Either or both spouses can choose to split their respective pension incomes. In other words, one spouse may elect to shift income and the other spouse accepts that income but has the option of whether or not he or she in turn wants to shift any of his or her own income. This creates a lot of opportunity for planning for the couple in respect of the income reported by each and the tax liability realized by each. Of significance is the timing of this election, as it occurs when the income tax returns are being prepared, after all income has been received for the year.

For individuals age 65 and older, eligible pension income is defined as income in respect of a life annuity from a pension plan; an annuity payment from a matured registered retirement savings plan (RRSP); a payment from a registered retirement income fund (RRIF); an annuity payment from a deferred profit sharing plan (DPSP); and the taxable portion of a non-registered annuity payment (prescribed and non-prescribed).

For individuals less than age 65 at the end of the year, eligible pension income is defined as income in respect of a life annuity from a pension plan and income received as a consequence of the death of a spouse arising from:

- an annuity under a matured RRSP;
- a payment from a RRIF;
- an annuity payment from a DPSP; or
- the taxable portion of a non-registered annuity.

One of the advantages of splitting pension income is to allow both spouses to claim the $2,000 federal pension tax credit. However, the rules contain provisions that may catch the unwary. The income that is shifted from one spouse to another retains its character. This means that the receiving spouse must meet the definition for eligible pension income noted above, which turns on whether the receiving spouse is age 65 or older. Consider an example where a spouse, age 67, who is in receipt of an RRSP annuity opts to split income with his 64-year-old spouse. In this case, the receiving spouse would not qualify for the federal pension income tax credit.

These new provisions provide couples with the opportunity to increase net cash flow within their economic unit. Given the potential complexities, guidance will be helpful to ensure the couple maximizes the results.

I/R 7401.00

FARMING

The federal Income Tax Act (the Act) provides several tax incentives to farmers, indirectly providing government subsidization. The Act defines farming as the tillage of soil; raising livestock; exhibiting livestock; maintaining horses for racing; raising poultry; raising animals for fur; dairy farming; fruit farming; and the keeping of bees.

However, sometimes taxpayers are involved in farming while at the same time being involved in other taxable activities. In order to ensure that the

farm incentives are appropriately focused, the Act distinguishes three types of farmers:

1) individuals for whom farming provides the bulk of their income and consumes the bulk of their time and energy;
2) individuals for whom farming is a sideline because there is another activity that generates more income and consumes more time than the farming activity, and that other activity consumes more time than the farming activity; and
3) individuals for whom farming is a hobby and who do not have a reasonable expectation of profit from farm activities.

The distinction is very important because a farmer from the first category would be entitled to deduct farm losses without restriction against other income in the year. A farmer in the third category would not be entitled to any tax relief for farming losses since they would be considered a personal expense; however, he or she would be taxable on any farming profit.

A farmer from category two may be allowed to deduct a portion of the farm losses against other income. The farmer will be able to deduct the lesser of the actual loss incurred and $2,500, plus one-half of the next $12,500 (i.e., a maximum of $8,750 of deductible losses from a $15,000 farming loss).

This wide variance in treatment encourages many taxpayers to try to arrange their affairs to maximize the tax benefits available.

While the three categories appear to be fairly well defined, there have been innumerable court cases over whether a farmer was full time, part time or a hobbyist. One such recent case involved a doctor where it was clear that her medical practice was her chief source of income and her farming activity had produced losses since its inception. However, the facts of the case showed that she operated the largest organic farm in New Brunswick. Even though she spent five days a week at her medical practice, she also spent four hours a day on her farm as well as weekends. The Tax Court agreed with the taxpayer's position and allowed her to deduct her farm losses without restriction against the income from her medical practice.

The activity of farming can provide significant therapeutic relief to some individuals and the Act will allow some tax relief in those situations that have a reasonable expectation of profit.

I/R 7401.00

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Publication Agreement # 40069004

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