



Probate and the Use of Joint Tenancy With Rights of Survivorship (JTWROS)

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Planning for one's death is never an easy process but it is a necessary one. One of the concerns that individuals must deal with prior to their death is the issue of the time consuming probate process and for certain provinces the application of probate taxes; hereinafter referred to as probate. Perhaps one of the most common strategies used to avoid probate is putting assets in Joint Tenancy With Rights of Survivorship (JTWROS).

The utilization of joint accounts to avoid probate is a valid strategy. However, Quebec residents cannot use JTWROS since an automatic right of survivorship does not exist under the province's laws. While JTWROS may be effective in avoiding probate, there are a number of potential issues that must be understood prior to making this decision.

WHAT IS PROBATE?

Probate is simply judicial evidence of the authority of the personal representative of the estate, for the benefit of third parties, to deal with the assets of the deceased.

The power that is given to the executor stems from the deceased's Will and not the Letters Probate (a court document validating a Will) therefore, the courts' role is simply to determine if the Will is valid. In the eventuality that a Will does not exist, the court issues Letters of Administration, a court document, and an Administrator is appointed. Under these circumstances the power of the "Administrator" resides with the court appointment.

Probate provides comfort to financial institutions and other third parties that the Will is not being contested, that there is no other Will in existence and that the executor or Administrator is authorized to deal with the deceased's assets. Hence, Probate is not a mandatory process of itself.

When an application for "Letters Probate" or "Letters of Administration" is made, the distribution of the estate may be delayed by approximately 6 months and probate taxes imposed where applicable. Hence, the strategy of an astute estate planner is to structure ownership of assets in such a way as to avoid the need to get the Will probated, and still be capable of distributing the assets of the estate.

JOINT OWNERSHIP AND PROBATE?

There appears to be great confusion with the use of a form of legal ownership called Joint Tenancy with Rights of Survivorship (JTWROS) and the ability to avoid probate through its use.

On the surface, the strategy of placing assets in joint ownership would appear to be a simple planning technique to avoid probate. The logic for this is that assets held in Joint Tenancy with Rights of Survivorship (JTWROS) do not form part of the estate of the deceased owner, therefore it would not be considered an asset subject to probate.

The problem resides with the fact that the full value of assets BENEFICIALLY owned by the deceased at death will form part of the estate of the deceased. Individuals must understand that the transfer to joint ownership must be a transfer of both beneficial and legal ownership to ensure that assets do not form part of the estate of the deceased.

LEGAL VS. BENEFICIAL OWNERSHIP

In common law jurisdictions, two forms of property ownership are recognized: legal and beneficial. Normally, "legal ownership" changes when title is transferred, registered or carried in the name of a person. Legal owners basically have the power to enforce their ownership rights against other persons. But, one person's legal ownership of a property may, however, be subject to another person's beneficial ownership of that same property.

Beneficial ownership is characterized by a person's entitlement to the use and benefit of property whether or not that person has concurrent legal ownership. It must be stressed that a person who has beneficial ownership rights represents an individual with a greater degree of control than someone that has mere legal ownership.

There have been numerous articles written in regards to the separating of these two types of ownership. The most commonly cited strategy is to have a legal advisor draft an agreement, between you and the other parties stating that you have maintained the beneficial ownership of the asset while giving up the legal ownership of the asset. The goal is to **not** have a disposition, for tax purposes, and to avoid probate.

The Canada Revenue Agency (CRA) position on the transferring of beneficial ownership is a question of fact. Therefore, a written agreement would not, in and by itself, ensure that beneficial ownership was NOT transferred. Simply put, a written agreement stating that beneficial interest is not transferred may not be accepted by the CRA. For the CRA's definition of beneficial interest one can always refer to the CRA Interpretation Bulletin IT-437R.

TAX IMPLICATIONS

The CRA has stated that where there is a change in legal ownership of property without any change in the beneficial ownership NO disposition for tax purposes occurs on the transfer of the property to joint ownership. In order to have a true joint tenancy arrangement, to avoid probate, there must be a transferring of both legal and beneficial ownership. Therefore, the transfer of legal and beneficial ownership must occur in order to avoid probate.

There is an exception to this rule and it relates to voluntary transfers of capital property between spouses. If assets are transferred to a JTWROS account between spouses, the property that was transferred may retain its original adjusted cost base (ACB). If the original ACB is maintained, all unrealized capital gains will be deferred until the death of the last surviving spouse and probate will also be avoided. Note that the spousal attribution rules will apply for investment income earned in a JTWROS.

As an alternative, the transferor spouse may elect to have the assets disposed of at fair market value for tax purposes. This may be advantageous if the transferor spouse had unused capital losses carried forward from previous years and imbedded unrealized capital gains in the assets being transferred to the JTWROS.

However, use of JTWROS with anyone other than a spouse will result in a disposition at FMV for tax purposes of a pro-rata share of the asset if probate is to be avoided in the future.

OTHER POTENTIAL ISSUES

Bankruptcy

The joint ownership transferors must be cognizant of the fact that joint ownership arrangements may expose the transferred assets to creditors of all parties.

Property that is held in joint tenancy with right of survivorship by a bankrupt (joint tenant #1) and another (tenant #2) is severed on bankruptcy. On the debtor's bankruptcy, the debtor's interest passes to the trustee in bankruptcy and the trustee becomes a tenant in common with the other owner.

Probate Fees and the Use of Joint Tenancy With Rights of Survivorship (JTWROS)

Tenancy in common is basically a form of co-ownership in which property is held in common with others but, in contrast with JTWROS, the share of a deceased tenant in common passes to his or her beneficiaries under his or her Will or intestacy and does not automatically pass to the surviving tenant or tenants in common.

It should be noted that the use of Tenancy in Common is not an alternative probate strategy to the use of JTWROS. The portion of the account owned by the deceased will **not** be excluded from the deceased's estate.

Control of Assets

Some of the control of the asset is lost once legal ownership of the asset has been transferred to joint ownership. This may not be a major concern amongst spouses but may be problematic if children are involved.

The transferor of the asset to a joint account must assure herself/himself, prior to the transfer, that the transferee is the intended beneficiary of the asset. At the death of the transferor, if she/he dies before the transferee, the asset will be given to the transferee regardless if a different intention is in the Will.

The Income Attribution Rules would apply if through the use of JTWROS the individual gifts to a minor or to one's spouse.

JTWROS and Testamentary Trusts

Given the assets in JTWROS do not form part of the estate of the tenant that dies first, there is no opportunity for these assets to flow into a testamentary trust. A key tax benefit of the testamentary trust is that income earned in a testamentary trust is taxed as a separate person (although no basic exemption can be claimed - \$7,756 for 2003). This feature allows potential income splitting for the beneficiaries. Therefore, although probate is avoided with a JTWROS, since no testamentary trust can be set up with the JTWROS assets, the beneficiaries may be subject to higher income tax in the future.

Divorce/Separation/Death

In cases of a divorce or separation the joint asset may become exposed to a claim under matrimonial property legislation. One may consider requiring the individual that will be receiving the joint interest to enter into a marriage contract to protect this joint interest.

If a spouse receives an inheritance during marriage and is considering putting this asset into a joint account they may consider getting independent legal advice to ensure that they are not inadvertently compromising their legal position with regards to the inheritance in the event of a marriage breakdown.

Professional advice should be sought before putting assets jointly with offspring. Difficult family property issues may arise if the offspring happens to predecease the parent.

Enduring/Continuing Power of Attorney and Joint Accounts

Individuals holding an enduring/continuing power of attorney should be aware that banks generally do not allow an attorney to transfer funds on which they have a power of attorney, for another person, to a joint account.

There is reluctance on the part of courts in Canada to allow such transfers. The reluctance could be due to the fact that this transfer does not constitute a benefit to the estate, but rather a benefit for the beneficiaries under the estate.

U.S. Citizens Residing in Canada

There may be a disadvantage for U.S. citizens residing in Canada holding assets in JTWROS. The disadvantage is caused by the potential loss of the U.S. Estate Tax exemption.

All U.S. citizens are subject to the U.S. Estate Tax, but they are also eligible for an exemption on this tax of up to \$1,500,000 USD. By having the account set up as a JTWROS a deceased U.S. citizen may be denying the surviving spouse the opportunity to utilize the deceased's U.S. Estate Tax exemption due to the fact that the assets flow to the surviving spouse.

CONCLUSION

The issues to be concerned with are the following:

- a) Legal and beneficial ownership must be conveyed in order to alleviate the time-consuming probate process and for some provinces the application of probate taxes, but control of the asset is lost.
- b) The use of JTWROS triggers unrealized capital gains of a pro-rata share of the asset, unless the recipient of the transfer is a spouse. If the recipient is a spouse then the transfer automatically occurs at ACB.

Note: The above strategies are based on the tax law in effect as of the date of this article. The article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with their personal tax advisors before taking any action based upon the information contained in this article.

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