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JOINT OWNERSHIP SOLVING OR CAUSING ESTATE PROBLEMS?

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As our Canadian population continues to age, wealth management, tax, and inter-generational transference techniques become increasingly relevant. Banks, credit unions, brokerages, and others are advising many older Canadians to hold their assets in jointly owned form. While this can be an effective strategy and appear to be a great idea at first glance, some pitfalls need to be considered. In fact, blindly following the advice can lead to completely unexpected and undesirable results.

Joint ownerships are not a simple mechanism, can be complicated, and require much thought before implementation. Merely adding one or more names on an existing asset to create a joint account will rarely accomplish what is intended.

JOINT OWNERSHIP DEFINED

Joint ownership is a legal arrangement under which more than one person has ownership rights to a particular asset, such as an investment account or property.

The **Canadian common law legal system** recognizes two fundamental types of joint ownership:

1. **Joint owners as tenants in common** — each joint owner has an interest in the property. The entitlement is in proportion to the owners' contribution at the time of acquisition, and this proportion goes to his/her respective estate upon death
2. **Joint owners with rights of survivorship** — each owner has an indivisible interest in the whole asset. When one owner dies, the remaining joint owner or owners immediately acquire full control and benefit of the asset. The deceased and his/her estate have no interest in the asset

continued on page 2...

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The **Supreme Court of Canada** has established that joint ownership can be interpreted in at least three different ways in respect of estate planning intention:

1. **Full or true joint ownership with rights of survivorship** — each owner is entitled to share in profits and is obligated to report any taxable income or gains derived from the asset; has the right to issue instructions on the use of the asset; and has a right of survivorship with respect to the others, which means if one owner dies the other(s) automatically own(s) the asset
2. **Joint ownership with right of survivorship and no control** — an owner grants the right of survivorship only and not ownership or control during his/her lifetime. Upon the death of the grantor, the surviving joint owner(s) receive(s) unencumbered rights to the asset

3. **Joint control with no right of survivorship** — an owner grants another person the right to issue instructions with respect to the asset, although that person does not actually share in the ownership of the asset. This person acts as a signatory or agent. On the death of the actual owner, the other person immediately loses the ability to make decisions about or act in respect to the management of the asset. The asset becomes part of the deceased's estate and decisions regarding it are made by the estate executrix in accordance with the last will and testament

Marital property division laws vary from province to province and can also be used to determine spousal entitlement regarding assets held jointly with a third party. If a marriage breaks down, assets held jointly by one spouse with a third party may become subject to property settlement calculations.

While individually, the above legal interpretations of joint ownership of property may or may not have a direct effect on taxation, legal, marital, or estate entitlement, combined, they assure that this form of ownership is anything but simple.

CREATING A JOINT OWNERSHIP ACCOUNT

Joint ownership accounts can basically be created in two ways:

1. Two or more persons together acquire property or open an account
2. One or more persons who already possess property or an account simply add another name(s) as owner(s) of the asset

REASONS for Joint Ownership

The principal reasons for joint ownership of savings and investment accounts or other forms of real property include:

EASE OF FINANCIAL MANAGEMENT — often, day-to-day financial management is most practical for one person to handle. Enabling another person to handle routine banking tasks would be an example

TAX PLANNING — joint accounts can be useful in splitting investment income and capital gains. Taxable income generated in a joint account and allocated to more than one tax payer could create tax savings

PROBATE FEE REDUCTION — many provinces assess significant probate fees on assets that flow through an individual's estate. Assets in a joint account with right of survivorship are excluded from probate fee calculations

SIMPLIFIED TRANSFER OF ASSETS ON DEATH — where rights of survivorship exist, the deceased joint owner has a level of assurance that his/her interest in the asset passes outside of sometimes complex estate administration and/or distribution procedures

PRIVACY — the value of assets flowing through an estate becomes a matter of public record. Individuals wishing such information to remain private sometimes use joint ownership to avoid public knowledge of their holdings

In addition to these commonly encountered reasons for joint ownership, there are also many additional personal or business situations where this estate planning strategy is useful. Your Nakamun advisor can help you decide where joint ownership would be advantageous.

HAZARDS AND CONSEQUENCES of Joint Ownership

Before placing assets into joint ownership, be aware of and assess the potential risks.

Since Canada's income tax act recognizes both legal joint ownership and the concept of beneficial ownership, many factors contribute to Canada Revenue Agency's determination of tax obligations of owners of jointly owned assets. The end result can be unexpected, unintended, and often unpleasant tax treatment of either capital gains or income derived on the asset.

Unexpected problems may also arise from the fact that many women use their husband's family name and initials. For example, Mr. and Mrs. R.M. Smith have a joint bank account and jointly own a condominium. Both assets are in the name of Mr. and Mrs. R.M. Smith with rights of survivorship. If Mrs. Smith dies; Mr. Smith remarries; Mr. Smith dies and leaves his estate to the children of his first marriage; the second Mrs. R.M. Smith, through the rights of survivorship, continues to use the condominium and bank account after her husband's death; when the second Mrs. R.M. Smith dies, the assets may not necessarily be part of her estate. To prevent any dispute as to the rightful owner, the proper names of both joint owners should be on the account.

Another unintended consequence can occur when spouses in a second marriage own property together as joint tenants and each have children from previous relationships. On the death of the first spouse, the property will pass by right of survivorship to the surviving spouse. The spouses may have had wills that provided for the property to be ultimately passed to the children of both spouses. However, the surviving spouse can change his/her will so that the property goes only to his/her children, and the children of the deceased spouse would receive nothing.

JOINT OWNERSHIP WITH ADULT CHILDREN

While joint tenancy is most common between spouses, the strategy has become increasingly common between parents and adult children. The purpose is the same — to simplify administration of the parents' estates and to minimize probate fees. These joint ownerships are most commonly created by gifting.

The intent of the parent is to continue to own and control the asset while alive and to leave it to the child on death. Unfortunately, parents often fail to realize that granting joint ownership immediately transfers rights to the child.

When a parent transfers assets into a full joint ownership with rights of survivorship with one adult child, the following takes place:

LOSS OF CONTROL — the parent cannot later cancel the transfer because of a change of mind; any joint owner is able to withdraw funds from the joint account at any time without the permission of the other owner; in the case of land, the parent cannot sell or mortgage the property unless the child agrees

INCOME TAX IMPLICATIONS — the transfer is a disposition for income tax purposes. For instance, a 50 percent interest in property transferred to a child is deemed to have been sold at fair market value and unless the asset is the parent's principal residence, accrued capital gains will be added to the parent's taxable income for that year. This could result in the parent having to pay tax even though no payment was received from the child.

In addition, one half of any future capital gains will accrue to the child. If the property is the parent's principal residence and the child lives elsewhere, the principal residence exemption will be lost

for the child's share of any future increase in value of the property. The child's share of any increase in value becomes subject to capital gains tax

PROPERTY TRANSFER TAX — in the case of land, property transfer tax is payable at the time of transfer, although there may be an exemption available if the property is the principal residence of either the parent or the child

EXPOSURE TO CREDITORS — the child's interest in the property is subject to claims by the child's creditors

EXPOSURE TO MARITAL PROPERTY CLAIMS — if the child is married and the marriage breaks down, the asset and/or its increase in value could be subject to claims by the child's spouse

DEATH — if the child passes away before the parent, the purpose of the joint tenancy is negated. If other children were also on title with the parent as joint tenants, on the death of the parent, the asset would pass only to the surviving children, and the family of the deceased child would receive nothing

Other problems can arise when putting assets into joint ownership with adult children. For example, a widow with three children puts an investment account in joint name with one child. She also has a will that states her assets are to be divided equally among her three children when she passes away. On her death, the funds in the jointly held investment account could be the subject of dispute. Were these funds intended to go to the child whose name is on the title or were they supposed to be shared among the three children?

TAX IMPLICATIONS OF JOINT OWNERSHIP WITH ADULT CHILDREN

When a parent owns an existing asset and chooses to add adult children as joint owners, there will be a deemed sale of a portion of the assets at their current value. For example, if three adult children become joint tenants with a parent, three-quarters of the asset would be deemed sold by the parent. If the asset had appreciated in value, the parent would owe taxes in the current year.

Example

\$100,000 in assets is set up in a joint account with right of survivorship with three adult children:	
Immediate deemed disposition by the parent — .75 of assets	\$75,000
Assume assets purchased at \$20,000	
Adjusted costs base — .75 of purchase value	\$15,000
Total capital gain to parent	\$60,000
Taxable portion – 50%	\$30,000
If parent is in highest tax bracket, tax owing	\$15,000

FULL AND COMPLETE DOCUMENTATION

When creating a joint account of any nature, full and complete documentation is the key to resolving disputes, confusion, or tax nightmares, and avoiding or defending litigation. The only effective method is to create solid written evidence of your intentions regarding the asset to be held jointly.

The document should be created and signed as close as possible to the date when the joint account is established.

This signed declaration should be kept with your original will in a safe place, which is disclosed to your named executors.

continued on page 4...

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While creating a joint account is simply accomplished, the intended purpose can easily fail. To avoid unintended, unpleasant results, do not transfer any assets into joint ownership without first discussing the matter with appropriate advisors, such as your lawyer, tax specialist, or your Nakamun advisor.

QUESTIONS that should be answered before owning real property jointly with other individuals:

- Will the property be held as joint tenants or as tenants in common?
- Is there a marriage contract or cohabitation agreement?
- Who paid for the property?
- Is the other owner aware of his/her ownership?
- Who pays the property taxes, insurance, utilities, and repair and maintenance?
- What is the purpose of the shared ownership?
- Is one child named as a beneficiary of the real property — either a principal residence or a cottage — and another child named as beneficiary of an RRSP or RRIF or a joint bank account?
- What are the intentions with respect to the real property on death — does an owner intend that the other owner will share ownership of the property with other beneficiaries?
- Has a tax professional been consulted?
- Who will pay tax due on any deemed disposition?
- Should there be a written agreement between the joint owners as to the disposition of the property on death of any joint owner?
- If a joint owner is married or cohabiting with another person, should that spouse acknowledge in writing that he or she has no interest in the jointly owned real property and will make no claim against it?

QUESTIONS that should be answered before owning a bank or investment account jointly with other individuals:

- What is the purpose of the joint account?
- What are the terms of the joint account, as set out in the written account agreement with the issuer?
- Will the account pass to the joint account holder by right of survivorship?
- Who are the joint account holders?
- Who are the beneficiaries of the estates of the joint account owners?
- Is any joint account owner a beneficiary of the estate of any other joint owner?
- Is any joint owner an executor of the estate of any other joint owner?
- Who has or will contribute to the account? How much? When?
- Who will have access to the account?
- Who reports the income earned on the account?
- Who pays the income tax, if any, earned on the income of the account?
- What are the intentions for funds in the account on death of any joint owner?
- Is the balance in the joint account to be included in any joint owners' estate?
- Is any balance in the joint account to pass by right of survivorship to the joint account holder for his or her own use?
- Are these intentions stated in the wills of the joint owners?
- Should there be a written agreement between the joint account holders as to the disposition of the funds?
- If there are more than two joint owners, what happens when any one or more dies?
- Should there be a written agreement between the joint owners to protect a joint owner's share of the account when he/she dies?
- If a joint owner is married or cohabiting with another person, should that person's spouse acknowledge in writing that he/she has no interest in the joint account and will make no claim against it?
- Has any joint owner designated different beneficiaries on any joint accounts?


PRACTICE REVIEWS AND PROFESSIONAL DEVELOPMENT

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Three or four times a year, the members of The Nakamun Financial Group meet to conduct a comprehensive review of each other's practices and improve or update our knowledge and understanding of a relevant component of our business. In the 35 years that our Group has existed, we've met in locations across Canada and around the world, often traveling to specific destinations to meet with experts who can provide the information we seek.

Sometimes, a product or service that is relatively new in Canada may have been available for years in another country. The members of the Nakamun Group will travel to visit with those more experienced and knowledgeable than we are to discuss issues and practices.

We've also traveled to visit and learn from experts on subjects important to our clients. For example, we've gone to Ireland to talk with the international investment experts at AGE, the Bahamas to find out more about offshore investments, and Phoenix to explore cross-border issues. Closer to home, we invite lawyers, accountants, product suppliers and others who can update us on estate planning, retirement planning, insurance, or whatever else can help us to provide the very best products and services to our clients.

The most important component of our regular meetings, though, is the practice reviews. We scrutinize each other's practices in infinite detail to ensure that our clients' interests are protected on an ongoing basis. 

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