Manulife Investments

INVESTMENT
insight

ALTER EGO TRUSTS: the answer to probate fees?

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TAX MANAGED INVESTING – STRATEGY 13

Alter ego and joint partner trusts have been gaining in popularity as a way to avoid probate, but are there alternatives?

WHAT ARE THEY

Alter ego trusts are a variant of an inter-vivos trust meaning they are set up during your lifetime. You must be 65 or older and be the sole beneficiary. While you can appoint a third party as trustee or co-trustee, you can also appoint yourself.

The joint partner trust is similar except that income is paid to you, your spouse or common-law partner, or a combination of the two. The joint partner trust – and income payments - continues until the death of the last survivor.

ADVANTAGES

Assets are transferred to an alter ego trust at cost allowing you to defer taxation of capital gains until the assets are sold or your death. You may elect to transfer at market value, which can be advantageous if you have significant capital losses or if you own certain qualifying shares. While individuals may claim a capital gains exemption on the sale of qualifying business shares, an alter ego trust cannot claim the same exemption.

Upon your death, the disposition of trust assets avoids probate and legal fees. While probate is a public process, the disposition of trust assets is private.

Most trusts are subject to the deemed disposition rule. Capital assets are considered sold every twenty-one years, which can generate a substantial tax bill. With an alter ego trust there is no deemed disposition until your death (unless you elect otherwise).

Transferring assets to a trust can also provide creditor protection.

THE DOWNSIDE

So why doesn't everyone set one up? As a formal trust, initial costs alone could amount to thousands of dollars. Additional costs for accounting, filing tax returns, and trustee fees are ongoing and could be substantial.

During your lifetime, trust income can be attributed back to you and taxed at your marginal rate. However, the deemed disposition of trust assets on your death is taxed at the highest marginal rate. Also, any successor trust is not a testamentary trust but an inter vivos trust. While testamentary trusts are taxed at the graduated rates applicable to individuals, inter vivos trusts are taxed at the top marginal rate.

Alter ego trusts are sometimes touted as a substitute for a will since the trust document directs the disposition of trust assets on your death. Care must be taken in drafting the document. If it looks too much like a will – and assets are substantial or their disposition contentious – the document could be open to legal challenge the same as a will!

ALTERNATIVES

Alter ego trusts offer the avoidance of probate and legal fees on death, creditor protection, and the ability to transfer assets without taxation of capital gains. Other available options provide similar benefits: a segregated fund contract or insurance company guaranteed interest contract (GIC) offers most of the advantages with substantially less cost and administration.

A segregated fund or insurance GIC contract with a beneficiary of the family class[1] offers the potential for creditor protection. When a beneficiary other than your estate is named, assets bypass your estate and are paid to the beneficiary on your death without payment of either legal or probate fees. Their disposition also remains a private matter. Distribution of assets directly to a named beneficiary is almost always faster than settling an estate. Unlike an alter ego trust, a trust established on your death with segregated fund or insurance GIC assets can be a testamentary trust.

In addition, a segregated fund or insurance GIC is easy and free to set up, unlike an alter ego trust, and - as the owner of the contract - you maintain complete control. Changing a beneficiary simply requires completion of a form rather than altering the trust. The accounting work is done for you and summarized on your tax slip; all you need to do is simply add the income when filing your tax return.

Lastly, capital losses of an alter ego trust can only be used within the trust while those of a segregated fund are allocated to you. This allows immediate application against other capital gains.

ALTER EGO TRUSTS	THE SEGREGATED FUND ALTERNATIVE
ADVANTAGES	**ADVANTAGES**
Creditor protection	Creditor protection
Confidentiality	Confidentiality
On death avoids probate fees & other estate costs	On death avoids probate fees & other estate costs
Transfer of assets does not trigger capital gains	Flow through of capital losses
DISADVANTAGES	Flexibility to allow for transfer of ownership and income splitting
Difficult and costly to change beneficiary	Easy and free to change beneficiaries
Capital gains on death taxed at top marginal rate	Capital gains on death taxed at individual's marginal rate.
Initial set up costs	Free to set up
Successor trusts are inter-vivos and taxed at top rate	Successor trusts can qualify as testamentary trusts
Ongoing costs	Capital guarantees on death & maturity

While alter ego and joint partner trusts offer some attractive features, segregated funds and insurance GICs offer most of the same advantages as well as some others without the additional costs.

[1]. In provinces other than Quebec, a family class beneficiary is any of the spouse, child, grandchild or parent of the annuitant. As of the publishing date, creditor protection in Quebec is uncertain.

INVESTMENT OPTIONS WITH MANULIFE INVESTMENTS

Manulife and its subsidiaries provide a range of investments and services to help investors create tax-preferred income and deductions against income:

Manulife Segregated Funds combine the growth potential offered by over 60 top-ranked investment funds, with the unique wealth protection features of an insurance contract. Through Manulife Segregated Funds, investors can limit exposure to risk through death and maturity guarantees, potential creditor protection features, and the estate planning benefits – all from a single investment.

The Manulife Investments GIC offers competitive rates plus investment options that include Basic, Escalating Rate and Laddered GIC Accounts. You benefit from a guarantee on your principle investment and diverse investment terms.

IDEAL CANDIDATE

Investors should consider segregated funds or insurance GICs as an alternative to alter ego trusts if they want:

- Low costs
- To avoid legal and probate fees
- Creditor protection
- Tax efficient disposition of assets at death
- The ability to create a testamentary trust at death
- Capital guarantees on maturity or death

FIND OUT MORE

With 30 years of experience in retirement planning and wealth accumulation strategies, Louise Guthrie leads the Manulife Investments Tax and Regulatory Services (TRS) team – a group of accountants, lawyers and other specialists skilled in proactively identifying opportunities for clients based on changing regulatory environments and the market.

TAKE ACTION

If you are looking for these features in an investment:

- Contact your financial advisor
- Decide how much you want to invest
- Name your beneficiaries and consider testamentary trusts
- Decide what funds – or insurance GICs – meet your investment goals

TRS Tax & Regulatory Services

For more information please contact your advisor or visit www.manulife.ca/trs

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