

Power of Attorney: How far can you go with Estate Planning?

Many of us consider a Power of Attorney (or "POA") document essential to the estate plan. The document is utilized while the donor (or "grantor") of the power is alive and usually incapacitated. The POA is distinguishable from a will, which takes effect on death. The question often arises as to what extent a person named in a POA (the "attorney") can engage in estate planning on behalf of the donor of the power. This Tax Topic will explore this particular aspect of planning.

What is the purpose of the POA?

A POA for property (Ontario, Nova Scotia and Manitoba also allow for a POA for personal care) is a document whereby the donor provides the authority to the attorney to manage and govern property and financial affairs usually when the individual becomes incapacitated. All provinces now allow the POA to become effective immediately on the date signed and continue throughout the incapacity of the donor. This is referred to as a "continuing or enduring" POA; the POA survives the incapacity of the donor. In most provinces, the donor must reach the age of majority (the age of majority varies from one province to another) before signing the document. The attorney becomes the agent of the donor; this may provide unlimited power to the attorney over the donor's property, making the POA a very powerful document. Caution should therefore be used when picking and appointing a person who will be in such a position of trust.

What are the Powers and Duties of the Attorney?

A POA may specifically set out in a limited fashion what it is that the attorney is permitted to do under the terms of the appointment or it can be very broad in nature. Most provincial Acts provide guidance as to the rights of the donor of the power, and the obligations of the attorney. The Ontario Substitute Decisions Act (SDA) serves as an example. Subsection 7(2) of the SDA provides that a person named in a Power of Attorney can do, on the grantor's behalf, anything in respect of property that the grantor could do if capable, except make a Will. In other words, the attorney cannot step into the

shoes of the donor and become the testator. Further guidance is set out in s. 32(1) of the Act describing the obligations of the Attorney. It states "... [The attorney] is a fiduciary whose powers and duties shall be exercised and performed diligently, with honesty and integrity and in good faith, for the incapable person's benefit. The key components of this section focus on the fiduciary role, where the person takes on a position of trust and any action taken must be "for the incapable person's benefit."

In addition to the duty to manage the property of the donor, attorneys are also charged with the making of reasonable expenditures for the care and support of the donor and the donor's dependants. Provincial legislation sets out the types of expenditures that must or may be made by the attorney in the case of the donor being incompetent. A unique point to Ontario's legislation is that an attorney has the option to make gifts or loans to the incapable person's friends and relatives and to make charitable gifts. No other provincial legislation contains such provisions. (See Appendix A).

Limitations of the Attorney

Generally, the common law has imposed certain limitations on the powers that can be delegated to an attorney. The limitations include the following:

- An attorney may not exercise the power of attorney for personal benefit unless authorized to
- 1. do so
 - under the terms of the document or unless the grantor provides consent;
- 2. An attorney cannot swear an affidavit or act where the donor's own personal knowledge or skill is required;
- 3. An attorney cannot make, change or revoke a will on behalf of the donor;
- 4. An attorney cannot assign or delegate his or her authority to another person unless specifically permitted by the document; and
- 5. An attorney cannot permit personal interests to conflict with those of the donor of the POA.

Generally, a fiduciary cannot delegate his or her decision-making functions but may delegate administrative tasks.

a) Making a Will on behalf of a donor

As cited above, a person cannot delegate the power to make a Will. This is codified in most provincial legislation. An attorney cannot make a testamentary disposition or sign a will or codicil on behalf of a donor. It should be noted however that some jurisdictions have enacted legislation, which gives the Court power to make or change a Will on behalf of an incapable person.

Since the attorney is limited in making a Will on behalf of the donor, the question arises as to how far the limitation extends? Does this apply to beneficiary designations on behalf of a donor under a life insurance policy, RRSP, RRIF or pension plan? Because such designations have testamentary implications, the answer is generally yes.

The courts have reviewed the question as to what constitutes a testamentary disposition. In regard to RRSPs, RRIFs and pension or employee benefits such plans are viewed as inter vivos trusts in nature and as such are arguably not a testamentary disposition. Having said that however, the case law seems to support the premise that such designations do constitute testamentary dispositions. As a result, attorneys appear not to be able to make a designation on behalf of a donor. As a general rule, the issue may depend upon the particulars of the plan.

b) Life insurance Designations on Behalf of a Donor

The same question regarding a testamentary disposition also applies when making a beneficiary designation under a life insurance policy. While provincial legislation indicates that an insured person may designate a person to be a beneficiary under a policy or to alter or revoke such designations, there is no indication that a designation equates to a testamentary disposition. There is however a great deal of case law that supports the argument that an attorney is not entitled to make, change or revoke a designation of a beneficiary of a life insurance policy on behalf of a donor. *Norwood on Life Insurance Law in Canada*, also indicates that an attorney cannot revoke or change a life insurance beneficiary designation since this would usurp the personal discretion of the insured.

c) Estate Planning by the Attorney on Behalf of the Donor

One of the most important issues that has arisen with the more widespread use of POAs, is the ability of the attorney to engage in tax or probate planning, or other estate planning on behalf of the incapable person. Generally as a rule of thumb, an attorney is best to seek the direction of the Court as to the nature and extent of the estate plan.

The following provides a sample of inter vivos plans that should be put before the Court for consideration:

- i) Plans seeking to avoid property being distributed on the incapable person's dying intestate or with his or her current Will in place;
- ii) Plans which would anticipate the entitlements of beneficiaries under a Will or under the rules of intestate succession; and
- iii) Plans to avoid or reduce probate fees and various taxes that may be payable by the estate on death.

There has been a trilogy of case law in this area providing direction as to the extent attorneys can plan. British Columbia courts have ruled on three applications by attorneys or committees (Court-appointed guardians of property) to make gifts or engage in other estate planning on behalf of an incapable person. These cases appear to be setting the stage as to allowable boundaries for planning. The cases are *Re Goodman*, (1998), 24 E.T.R. (2d) 194 (B.C.S.C.), *O'Hagan v. O'Hagan*, [2000] B.C.J. No. 204 (B.C.C.A.) and *Re Bradley*, [2000] B.C.J. No. 205 (B.C.C.A.).

In *Re Goodman*, the son of an incapable woman applied to Court for approval of the transfer of a Victoria, B.C. property to him, and an Alberta property to his sister. The plan was essentially an advance on the inheritances of he and his sister on an equal basis. The Court denied the application for several reasons. There was no independent evidence of what the mother would have intended had she been capable, no financial need had been demonstrated on the part of the children, and there was no evidence of tax savings to the mother other than the reduction of probate fees. The transfer would also have triggered capital gains.

In the case of *O'Hagan v. O'Hagan*, the family of a wealthy 89-year old man sought the approval of the Court of an estate-planning scheme that involved the reorganization of shares in the man's companies. Although the lower Court dismissed the application, the Court of Appeal approved it. The Court of Appeal held that the scheme would result in significant tax savings. There were also no proposed dispositions of the man's property, and his estate was large enough to provide for his needs many times over for the remainder of his lifetime (which was expected to be relatively short).

In *Re Bradley*, the incapable person was a wealthy 65-year old woman who, although a Canadian resident, was a U.S. citizen and would pay significant U.S. estate taxes on death. An American

lawyer made a recommendation to the woman's second husband and to the woman's sons from a previous marriage and their wives and children. The Committee sought approval of a plan, which involved a series of annual gifts to the husband and to each of the sons, their wives and children. The sons consented to the transaction.

While the British Columbia Supreme Court approved the plan, the Court of Appeal overturned the ruling. The Court of Appeal, which coincidentally heard the case at the same time as the O'Hagan case, stated that the possibilities in Bradley were much different from those in O'Hagan. Mrs. Bradley was 65 years old, not 89, and could live for many years. If her condition deteriorated, the expenses in relation to her care could increase significantly. The proposed gifts would reduce her estate dramatically, from \$2.6 million to roughly \$800,000. The Court held that in O'Hagan, the incapable person's interests would not be compromised in any way but in Bradley they would.

The judgment of the B.C. Court of Appeal in Bradley illustrates the principle that the Court will not approve estate plans that deprive the incompetent person of his or her property rights to a greater extent than is reasonably required to achieve the intended estate planning objective. Case law in Ontario has also supported this same premise.

Other cases have also considered additional factors including the following:

- i) the possibility, however slim that the incapable person may recover and expect to find his or her affairs as he or she left them; and
- ii) the necessity of the proposed transaction.

Generally, the Courts seem prepared to allow a plan that creates tax savings or other benefits for the incapable person and his or her family. As long as the interests of the incapable person are protected and he or she will not be deprived of funds needed for his or her care the Court appears to accept such plans. The B.C. Court of Appeal recommended in both O'Hagan and Bradley that Court approval should be sought where the attorney is in a conflict of interest due to his or her status as a family member who stands to benefit from a personal transaction.

Since the attorney is acting in a fiduciary capacity, the attorney must manage the financial affairs of the incompetent person for the benefit of that person; the attorney is not permitted to direct property to his or her own benefit or for the benefit of third parties. The attorney also has no authority to change the direction in which property would have flowed at the death of the incompetent person according to that person's Will.

(d) Planning with trusts - alter ego trusts/joint partner trusts

An attorney may also consider whether he or she can utilize trusts when tax-planning or estate planning on behalf of the incompetent person. With the introduction of new planning opportunities available through alter ego trusts and joint partner trusts, the attorney has new considerations for transferring property to avoid the application of probate fees/tax (referred to estate administration tax in Ontario). Alter ego and joint partner trusts are revocable in nature. It is uncertain as to whether an attorney has the power to establish a revocable trust. If the proposition in the O'Hagan case is applied, then arguably the transfer of assets to a trust would not be viewed as a testamentary act and would therefore be permissible within the parameters of various provincial legislation (e.g. ss. 7(2) of the Ontario SDA). Since the trust would be created for the sole benefit of the incompetent person during his or her lifetime, it is difficult to imagine that this would not find favor with the Court or with provisions in provincial legislation. However, to avoid any uncertainty as to the availability of the rollover to the trust, an advanced ruling should be sought by the attorney from Canada Customs and Revenue Agency (CCRA). In turn, CCRA may require the attorney to seek Court endorsement that the attorney is acting within the scope of his or her power granted in the POA to set up the trust.

Conclusion

There are many important issues and considerations facing an attorney once they step into the role conferred upon them through a POA. Persons acting under a POA must keep in mind that the incapable person has not yet died. The assets are still the donor's assets, and unless clear benefit can be shown, without risk or detriment to the incapable person, transactions, which dramatically alter the affairs of the person, will not be permitted.

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