

Getting A Handle on the Alter Ego and Joint Partner Trusts

By Albert S. Frank, LL.B.

New legislation is bringing in two new kinds of trust: the alter ego trust and the joint partner trust.

For an alter ego trust:

- The taxpayer creating the trust – the Settlor – must be alive and 65 years old or older;

- The trust must be created after 1999;

- The Settlor must be entitled to all income of the trust arising before the Settlor's death; and

- Nobody else, before the Settlor's death, may receive or otherwise obtain any of the trust's income or capital.

A critical fact setting the alter ego trust apart from ordinary trusts is that property may be placed in the alter ego trust without triggering an immediate deemed disposition for tax purposes. Instead, the deemed disposition takes place when the Settlor dies.

The joint partner trust is a similar type of trust for Settlers who have a spouse or common-law partner. The Settlor and the Settlor's spouse or partner must be entitled to all income of the trust arising before the later of the deaths of the Settlor and the spouse or partner. Before the later of those deaths, no

other person may receive or otherwise obtain any of the trust's income or capital.

These trusts give rise to many tax questions that I shall not deal with in this article. Suffice it to say that clients and their advisors shall have to review the tax implications not only globally but also on an asset by asset basis.

Creditor Proofing

These trusts have potential as methods of creditor proofing.

Given proper care in structuring the trusts in the first place, it should be difficult or impossible for creditors of the Settlor or of a beneficiary to break through the trust structure so as to take money or other property being held by the trust. After all, it is the trust – not the Settlor or the beneficiary – that owns the trust property.

It might be best to make the trust irrevocable. If the Settlor or a beneficiary has the power to undo the trust, there is a chance that a Court, on behalf of a creditor, might order the Settlor or beneficiary to do so.

For example, if the Settlor or a beneficiary has gone bankrupt and wishes to be discharged from bankruptcy, the Court might well impose conditions in the discharge Order. I have never researched the question of whether the Court could legitimately include a condition that the bankrupt Settlor or beneficiary undo the trust and hand the trust property over to the creditors.

No doubt many clients would prefer to structure the trust in such a way as to make this issue as unlikely as possible to arise.

The best time to creditor proof is before there are any serious actual or potential creditors. Of course, with no danger on the horizon the client might wonder whether it is worth the loss of flexibility involved in structuring for creditor proofing. "I'm not in business anymore, and I pay my bills. What creditors am I going to have?"

Suppose the Settlor is carrying a cup of hot coffee while walking in an American city. During the course of an attempted mugging, the coffee winds up in the mugger's face. An American jury awards substantial damages against the Settlor for hurting the mugger.

Or to take a likelier scenario, suppose the Settlor is responsible for an automobile accident and does not have enough insurance to cover all damages.

Moreover, the Settlor's spouse or children, who could be beneficiaries depending on the situation, might not be as reliable as the Settlor in avoiding debt.

Trusts as Will Substitutes

The property in the trust belongs to the trust, not to the Settlor or the Settlor's partner or any beneficiary. So the property is not part of the Settlor's estate upon death. This has various advantages, including:

- Probate fees/taxes do not apply to the trust property;

- Probate documents, including the Will and information as to the property, are public records. Information about a trust is more private;

■ The death does not hinder management of the trust property, because there is no need to have anything probated in order to grant authority to act under the trust;

■ Creditors of the deceased Settlor have the first claim against the estate, but on death would generally have no claim against the trust property; and

■ Various provinces have legislation allowing the Courts to override the provisions of Wills. It is much harder to override the provisions in the trust as to what is to happen to the trust property upon the Settlor's (or Settlor's partner's) death.

Conclusion

These new trusts give rise to many issues, but the possible advantages could make the issues worth exploring for many clients.

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The above article originally appeared in the February, 2002 issue of ***The Bottom Line***. Note that although trusts are often used for tax purposes, and the tax aspects should be reviewed when considering putting money or other assets into trust, there are other purposes for a trust. These purposes include creditor proofing and the use of trusts to enhance privacy.

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