TIPS & TRAPS OF CHARITABLE GIVING THROUGH ALTER EGO AND JOINT PARTNER TRUSTS

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1. INTRODUCTION

Alter ego trusts and joint partner trusts are frequently referred to as "will replacements" and are useful estate planning tools particularly in jurisdictions where probate fees are high and dependants' relief legislation is a concern. However, there are significant differences between gifting by will and gifting through such trusts. Making charitable gifts through these trusts requires careful planning to ensure the gifts are properly effected and that the tax benefits of the gifts can be realized. This paper will discuss the nature of these trusts, some of their advantages and disadvantages and some issues to consider when gifting to charities through such trusts.

2. THE LEGISLATION

Alter ego and joint partner trusts result from amendments to the Income Tax Act (Canada) (the "ITA") which were first announced in December 1998. Draft legislation was introduced in 1999 and after some delay, the amendments received Royal Assent on June 14, 2001. The amendments apply retroactively to transfers to trusts after 1999.

3. ALTER EGO TRUSTS

In order to qualify as an alter ego trust[1]:

(a) the trust must be created after 1999;

(b) the trust must be created by a person (the "Settlor") who is at least 65 years old;

(c) the Settlor and the trust must both be resident in Canada;

(d) the Settlor must be entitled to all the income of the trust that arises before his or her death;

(e) before the Settlor's death, it must not be possible for any person, other than the Settlor, to receive or otherwise obtain the use of the income or capital[2] of the trust; and

[1] Section 73(1.01)(c)(ii) of the ITA.

(f) the trust must not elect out of section 104(4) of the ITA which deems the trust to dispose of its assets upon the death of the Settlor[3].

While there are restrictions on who can benefit from the trust before the Settlor's death, after the Settlor's death any person may benefit from the trust. In addition, the trust may continue after the death of the Settlor for the benefit of other beneficiaries or it may be terminated and its property distributed much in the same way as could be provided in a will.

4. JOINT PARTNER TRUSTS

Joint partner trusts are similar to alter ego trusts except that both the Settlor and his or her spouse or common law partner[4] may benefit from the trust. In order to qualify as a joint partner trust[5]:

(a) the trust must be created after 1999;

(b) the Settlor must be at least 65 years old;

(c) the Settlor and the trust must be resident in Canada;

(d) the Settlor and the Settlor's spouse, in combination with each other, must be entitled to all of the income of the trust that arises before the death of the survivor of them;

(e) before the death of the survivor of the Settlor and the Settlor's spouse, it must not be possible for any person, other than the two of them, to receive or otherwise obtain the use of the income or capital of the trust; and

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[2] There is no requirement that capital be distributed to the Settlor so long as no one else can obtain the use or benefit of it while he or she is living.
[3] See the definition of "alter ego trust" in section 248 and section 104(4)(a)(ii.1) of the ITA.
[4] See the definition of "common law partner" in section 248(1) of the ITA that includes partners of the same sex. For the purposes of this paper, references to "spouse" include both legally married and common law partners.
[5] Section 73(1.01)(c)(iii) of the ITA.

(f) the trust must not elect out of section 104(4) of the ITA which deems the trust to dispose of its assets upon the death of the survivor of the Settlor and the Settlor's spouse[6].

On the death of the survivor of the Settlor and his or her spouse, other individuals may benefit from the trust on a ongoing basis or upon termination.

5. TAXATION OF ALTER EGO AND JOINT PARTNER TRUSTS

Although an exhaustive discussion of the taxation of these kinds of trusts is beyond the scope of this paper[7], there are three key features that should be noted. First, and most importantly, one of the main advantages of alter ego trusts and joint partner trusts is that property can be transferred to the trusts on a "rollover" basis such that no income tax arises at the time of transfer to the trust[8]. The trust receives the property at the Settlor's cost for tax purposes. On the death of the Settlor (in the case of an alter ego trust) or the survivor of the Settlor and his or her spouse (in the case of a joint partner trust) the trust will be deemed to have disposed of all of its property at fair market value. It is only then that any capital gains and losses will be realized. The tax liability arises in the trust, not in the hands of the Settlor[9].

Second, section 75(2) of the ITA would usually be applicable to attribute all the income and capital gains arising in the trust before the death of the Settlor back to the Settlor. Section 75(2) applies when the capital property of the trust can revert to the Settlor or where the Settlor can exert control over how and to whom the property is distributed[10]. Whether the application of

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[6] *Supra* note 3.

[7] For a more extensive discussion, see the article by C. Theriault, "Alter Ego and Joint Partner Trusts" 21 E.T.P.J. 345 and the paper by D. Thompson, "Joint Spousal or Common-Law Partner Trusts and Alter Ego Trusts as Will Substitutes: Tax Aspects" (paper presented at the Pacific Business and Law Institute conference in Vancouver, B.C., June 1, 2004).

[8] Unless an election is made otherwise. See *supra* note 3.

[9] It is important to note that like other inter vivos trusts, alter ego and joint partner trusts are taxed at the top marginal rate. This may be insignificant if the Settlor and the Settlor's spouse are already in the top tax bracket in the same province in which the trust is resident but it may be significant if the trust is resident in a different province with lower rate (such as Alberta).

[10] For example, control by the Settlor would be found where the Settlor can determine to whom property is distributed. This would occur where the Settlor is the sole trustee and has discretion as to the distribution of capital property. Alternatively, the Settlor may also exert control where the Settlor's consent is required to transfer property. This might arise, for example, where the Settlor is a trustee

section 75(2) will be relevant to the planning will depend on the circumstances of the Settlor. For example, if the Settlor is already taxed at the top marginal rate, it will make little difference if the trust income is attributed back to him or her as the trust is also taxed at the top marginal rate (assuming the Settlor and the trust are resident in the same province). If the Settlor does not want section 75(2) to apply, the Settlor must not be entitled to the capital of the trust, nor have control over its distribution.

Third, the application of the 21 year rule is deferred until the death of the Settlor (in the case of an alter ego trust) or the death of the survivor of the Settlor and the Settlor’s spouse (in the case of a joint partner trust). The 21 year rule will only usually be a concern if it is intended that the trust will continue in existence for a period of longer than 21 years after such time.

6. ESTATE PLANNING ADVANTAGES

From an estate planning perspective, alter ego and joint partner trusts are implemented most frequently for the non-income tax benefits they provide. The following is a discussion of some of these non-income tax advantages.

(a) *Incapacity planning*

For many individuals, planning for incapacity is a greater concern than planning for the distribution of their assets on death. Alter ego and joint partner trusts can be viewed as a more elaborate form of a power of attorney[11]. By the appointment of initial trustees and a mechanism for the appointment of successor trustees specified in the trust agreement, these trusts can provide greater flexibility and continuity in the management of a person’s financial affairs. If, for example, the Settlor is the initial trustee, the Settlor would have control over the trust property until he or she became incapable or resigned. At such time, successor trustees would be appointed who would continue to manage the trust assets upon the same terms and conditions as before without delay or loss of continuity.

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acting in concert with one or two other trustees and the Settlor’s consent is required because of unanimity requirements or the trust document requires that the Settlor be one of the majority in making decisions.

[11] For a comparison of the differences between using a power of attorney and an alter ego trust or joint partner trust for incapacity planning, see the article by Margaret O’Sullivan, “Using Alter Ego and Joint Partner Trust as Will and Power of Attorney Substitutes For the Elder Client”, 2000 Ontario Tax Conference, (Toronto: Canadian Tax Foundation, 2000), 8:1-27.

As well, by specifying a mechanism for the appointment of successor trustees in the trust agreement, the assets held in the trust are beyond the reach of future caregivers and friends who might try to improperly influence the Settlor to make “gifts” to them or who might seek to be named as his or her attorney or guardian for improper purposes.

(b) ***Privacy***

A trust agreement is private. By contrast, when a person dies and a grant of probate or letters of administration are required to administer his estate, the applicant must file a number of documents with the court including a copy of the will, if any, and a list of the assets and liabilities of that person at the time of death. The documents filed with the court in such an application are public documents and, as a result, may be viewed by any member of the public. However, if property is held in a trust, the deceased does not own those assets at his or her death and therefore those assets need not be disclosed on an application for a grant of probate if such an application is required. This can be particularly important for families who are well known in the community.

(c) ***No Probate Taxes Payable on Trust Assets***

The fact that probate fees are not payable on trust assets is particularly important in jurisdictions such as British Columbia and Ontario where probate fees (taxes) are significant. In British Columbia, probate fees are charged at the rate of 1.4% of the gross value of the Settlor’s estate[12]. However, no probate fees will be imposed upon assets in an alter ego or joint partner trust since those assets are not owned by the Settlor and do not form part of the Settlor’s estate for probate purposes[13]. This could result in a saving of $14,000 per $1,000,000 of value of property.

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[12] *Probate Fee Act* S.B.C. 1999 c. 4 . This Act was amended in 2004 to broaden the scope of property that is subject to probate fees in British Columbia. Previously, probate fees were payable on property which was situate in British Columbia. Probate fees are now payable on tangible real and personal property that is situate in British Columbia and, if the deceased was ordinarily resident in British Columbia immediately prior to death, on the deceased’s intangible property, *wherever* situate. Thus, intangible property, such as shares in a company, that are situate in another jurisdiction may now be subject to probate fees in British Columbia.

[13] Unless, of course, the terms of the trust document provide that on the death of the Settlor, the assets are to be distributed to his or her personal representative and distributed in accordance with the terms of his will. However, such planning would be highly unusual, particarly in provinces such as British Columbia.

(d) *Orderly Administration of Assets and Continuity*

By using a trust, the probate process can often be avoided entirely. Applying for a grant of probate can be time consuming and can cause delay in the administration of an estate because of the compliance required by the courts (for example, in serving all relevant parties) and the delay in issuing a grant due to the backlog of applications. Certain assets (such as real property) may be effectively frozen until a grant of probate is obtained and this can be a significant disadvantage. However, if that property is held in an alter ego or joint partner trust, the transition on the death of the Settlor (or the Settlor's spouse, as the case may be) can be seamless. It is not necessary to prove the authority of the trustee to administer the trust and distribution of the property can occur almost immediately if directed by the trust agreement.

(e) *Wills Variation Act Protection*

In British Columbia, the *Wills Variation Act*[14] presents a unique planning challenge. Under this Act, the deceased's spouse (including a common law spouse) and children may apply to court to vary the terms of his or her will if the deceased has not made adequate provision for the maintenance and support of them. The success of a claim will depend to a great extent on the particular facts of the case. As a result, it is difficult to predict whether a court will uphold the provisions of a particular will if challenged. The courts in British Columbia allow adult children who are financially independent of the deceased to make successful claims on the basis of a "moral" obligation. These kinds of challenges are a particular problem in second and subsequent marriages where there are spouses and children from different relationships.

In order to prevent a claim from being initiated, individuals often establish an alter ego or joint partner trusts to avoid. Because the assets in an alter ego trust or joint partner trust do not form part of the Settlor's estate on death, those assets are not governed by the Settlor's will and are therefore are not subject to any *Wills Variation Act* claim. In this way, the Settlor has greater comfort that his or her intentions will be carried out without interference from the court. For charities, this is a significant benefit, as a gift under such a trust cannot be varied by the court. Often in such actions, it is the share of a charity that is reduced in order to accommodate the claims of spouses and children.

[14] R.S.B.C. 1996 c. 490.

(f) *Creditor Protection*

Since legal title to the trust property is held by the trustee, this affords the Settlor (and his or her spouse in the case of a joint partner trust) some measure of protection against claims being advanced by his or her future creditors. In the case of an alter ego or joint partner trust, the distribution of income during the lifetime of the Settlor (and the Settlor's spouse in the case of a joint partner trust) is mandatory and may be attached by creditors. However, if the distribution of the capital is in the discretion of the trustee it may be more difficult for creditors to access the capital.

Notwithstanding that these trusts can provide a measure of protection against future creditors, it is important to ensure that the transfer of property to the trust is not a fraudulent conveyance or preference. The case of *Stone v. Stone*[15] has caused some concern in this regard. In this case, transfers to an inter vivos trust to avoid a claim by a surviving spouse under the *Family Law Act* in Ontario were held to be fraudulent conveyances and set aside. While the family law legislation is different in every jurisdiction, practitioners must be aware of the possibility that a transfer to an alter ego or joint partner trust may be viewed as a fraudulent preference or a fraudulent conveyance which can be set aside.

(g) *Protection of Beneficiaries*

On the death of the Settlor (or the survivor of the Settlor and his or her spouse in the case of a joint partner trust), it is possible to make distributions either outright to named beneficiaries or to provide that their interests be held in trust. Whether it is appropriate to make an outright distribution or to hold property on trust will depend on the particular circumstances of the beneficiary. However, by holding property in trust for a beneficiary, it is possible to provide him or her with some protection against claims by his or her heirs, spouses, common law partners or creditors. For example, a Settlor might foresee a marriage breakdown of a beneficiary and direct that his or her interest be held in the trust so as to protect that beneficiary's interest from a matrimonial claim by the spouse. As well, discretionary trust provisions may be appropriate if the beneficiary is a spendthrift or where the beneficiary is disabled[16]. In this way, real benefits can be gained by the beneficiary by having his or her share held in a trust rather than being

[15] (1999) 46 O.R. (3d) 31 (Sup. Ct.), aff'd (2001) 55 O.R. (3d) 491 (C.A.).

[16] An outright distribution may disqualify a disabled beneficiary who is receiving government assistance from receiving such assistance in the future.

distributed outright from an alter ego or joint partner trust. While this planning can be done through a will, there is a much smaller chance of if the planning being attacked or set aside if it is done through an alter ego or joint partner trust[17].

7. SOME DISADVANTAGES TO ALTER EGO AND JOINT PARTNER TRUSTS

Along with the advantages associated with alter ego and joint partner trusts, there are also a number of disadvantages which, depending on your client, may be significant. The following is a discussion of some of these disadvantages[18].

(a) *Increased Costs*

Trust can be complex legal documents to prepare, depending on the nature of the assets being transferred to the trust, the tax considerations and the circumstances of the Settlor and/or the Settlor's spouse and family. As well, on an ongoing basis, there will be legal and accounting fees associated with the administration of the trust and possibly trustee fees. This latter expense may be particularly significant if a financial institution is acting as the sole trustee or as one of the trustees.

(b) *Added Complexity*

Establishing an alter ego or joint partner trust adds an extra layer of complexity to an estate plan. The trustees will need to administer the trust and document their decisions. They will need to establish separate bank accounts and register property in their names. They have a responsibility to keep accounts regarding the trust and may also need to file income tax returns for the trust. For many clients, establishing and maintaining a trust may be simply too time consuming and complex.

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[17] As mentioned above, the *Wills Variation Act* does not apply to property held in alter ego or joint partner trusts. Although any trust can be attacked for lack of capacity or undue influence, it is much less likely for such a claim to be successful when compared to similar challenges to a will.

[18] There are a number of technical income tax disadvantages associated with alter ego and joint partner trusts. For a more detailed discussion, see C. Thériault and D. Thompson, *supra* note 7. For example, the $500,000 capital gains exemption for qualified small business corporations may not be claimed if the shares are held in an alter ego or joint partner trust at the time of the death of the Settlor or his or her spouse.

(c) *Loss of Control*

As the Settlor is transferring legal and beneficial ownership of his or her assets to a trustee (albeit to be held primarily for his or her benefit), the Settlor may be concerned about the loss of control over his or her property[19]. The trustee will have authority over the trust property. As well, other beneficiaries (other than the Settlor) will have rights in relation to the trust[20]. Anxiety regarding the loss of control can be minimized in a number of ways. First, the Settlor can also be the trustee or one of the trustees and can maintain control in that capacity[21]. Second, the trust agreement can be drafted to ensure that the Settlor retains control over the appointment of trustees. For example, the Settlor may be given the power to add or remove trustees while the Settlor is competent. Finally, the trust agreement can be drafted to give the trustee discretion to encroach on capital in favour of the Settlor (or the Settlor's spouse in the case of a joint partner trust). If the trustee has discretion to encroach on capital, it would be possible for the trustee to distribute all of the trust property to the Settlor (or the Settlor's spouse in the case of a joint partner trust) prior to his or her death (or the death of his or her spouse in the case of a joint partner trust) and effectively wind up the trust.

(d) *Loss of Marginal Tax Rates*

Alter ego and joint partner trusts are inter vivos trusts and as such, are taxed at the highest marginal rate. As discussed previously, this may not be significant while the Settlor is alive as the income from the trust is usually attributed back to the Settlor and taxed in his or her hands. However, on the death of the Settlor (in the case of an alter ego trust) or the survivor of the Settlor and the Settlor's spouse (in the case of a joint partner trust), there will be a deemed disposition of the assets of the trust and the income arising in the trust will be taxed at the highest marginal rate. By contrast, if the same property was held by the Settlor personally, on the Settlor's death there would also be a deemed disposition of his or her property but the tax payable would be subject to the Settlor's graduated tax rates. Thus, it may be that there is more overall income tax to pay on the death of the relevant individual if property is held in an alter ego

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[19] This may be particularly true with a joint partner trust where the Settlor contributes the property to the trust but it is held for the benefit of both the Settlor and his or her spouse.

[20] For example, the trust document will usually specify beneficiaries who are to benefit on the death of the Settlor (or the Settlor's spouse in the case of a joint partner trust). These beneficiaries may be entitled to an accounting and may be entitled to a copy of the trust document.

[21] Although there may be adverse tax consequences in so doing - consider the application of section 75(2) of the ITA.

trust or joint partner trust than if held outright. However, this will not likely make a significant difference if the Settlor (or the Settlor's spouse in the case of a joint partner trust) is being taxed at the highest marginal rate.

As well, the opportunity to take advantage of the graduated rates applicable to testamentary trusts may be lost using alter ego and joint partner trust. Testamentary trusts are those created on or as a consequence of the death of an individual and are often established through an individual's will for his or her spouse or children. This allows a spouse or child to take advantage of their own graduated tax rates as well as the graduated tax rates applicable to the trust. Thus, there may be an overall tax savings simply by having part of the income taxed in the trust and part of the trust's income taxed in the hands of the beneficiary. However, when an alter ego or joint partner trust creates a subsequent trust on the death of the Settlor (or the survivor of the Settlor and the Settlor's spouse in the case of a joint partner trust), the Canada Revenue Agency ("CRA") does not view that subsequent trust as a testamentary trust[22] and the income in that trust would be taxed at the highest marginal rate. For this reason, if an individual is considering establishing a trust for his or her spouse or children after his or her death, it may be more tax efficient to do so by way of his or her will rather than through an alter ego or joint partner trust. However, often individuals are prepared to forego the availability of graduated tax rates applicable to testamentary trusts in favour of other non-tax advantages associated with establishing alter ego and joint partner trusts.

8. CHARITABLE GIVING CONSIDERATIONS

Notwithstanding that alter ego and joint partner trusts are viewed as "will substitutes", there are some significant differences between making charitable gifts in wills and in these trusts. The following is a discussion of the some of the differences as well as some special issues to consider when making charitable gifts in alter ego and joint partner trusts.

(a) *Restriction on Gifts During the Lifetime of the Settlor (or the Settlor's Spouse)*

As discussed above, while the Settlor of an alter ego trust is alive, the Settlor is the only person who can benefit from the income and capital of the trust. In the case of a joint partner trust, only the Settlor and the Settlor's spouse can benefit from the income and capital of the trust the in until the death of the survivor. As a result, the trust is not able to make any charitable gifts

[22] As the trust is not created as a consequence of the death of the individual.

before the death of the relevant individual. This can be important as often the majority of a person's assets are transferred to the trust and it is from that pool of assets that a gift would usually be made. One strategy to circumvent this restriction is to have the trustee distribute trust property to the Settlor (or the Settlor's spouse in the case of a joint partner trust) who could, in turn, could make the charitable gift in his or her personal capacity. This may achieve the Settlor's (or the Settlor's spouse's) philanthropic intent, but as discussed in (c) below, it is important to avoid a mismatch where the donation tax credit is available to the individual, but the taxable income against which it could be used arises in the trust.

(b) ***Donation Tax Credit Limit***

The donation tax credit available to a trust in any year is limited to 75% of the trust's income for that year. By contrast, 100% of the individual's net income is eligible for the donation tax credit in the year of death and in the preceding year[23].

(c) ***Mismatch of Tax Liability and Donation Tax Credit***

The Settlor and the alter ego trust or joint partner trust are separate taxpayers and file separate income tax returns. This is an important fact to remember when considering which property to transfer to an alter ego or joint partner trust. In an ideal world, the goal is to ensure that on the death of the relevant individual (i.e. the Settlor or the Settlor's spouse) the property with accrued capital gains and the property with capital losses are held by the same taxpayer so that they can offset each other. If this fact is overlooked, a situation may result where the Settlor has significant capital losses on the property forming part of the Settlor's estate on death but the alter ego trust has significant capital gains. The losses in the Settlor's hands cannot be used to offset the gains arising in the trust or vice versa.

A similar problem arises with charitable donations. Estate planners need to be careful to ensure that the donation tax credit will match the taxpayer who has the tax liability on death. For example, if a Settlor makes a charitable donation through his or her will, but the majority of his or her assets are held in an alter ego trust, on the Settlor's death there will be a deemed disposition of the property in his or her name as well as a deemed disposition of the property in the alter ego trust. If the deemed disposition in the trust gives rise to significant capital gains, the donation tax credit from the gift made in the Settlor's will cannot be used to offset the capital

[23] Section 118.1(1) of the ITA, definition of "total gifts".

gain in the trust. Thus, it is important to consider not only what property is contributed to the trust and what remains in the Settlor's estate but also to consider whether is it most efficient to make a charitable donation through the Settlor's will or through the alter ego trust.

(d) *No Carry Back*

When a donation is made in a will, if the donation exceeds the available limit for the terminal taxation year, the unused portion of the donation tax credit can be carried back to offset tax arising in the year preceding death[24]. When a donation is made through an alter ego or joint partner trust, there is no ability to carry back any excess donation tax credit. The donation tax credit must be used by the trust in the year of the death of the relevant individual (i.e. the Settlor or the Settlor's spouse) or in the following five years[25].

(e) *Timing Issues*

The year end for all inter vivos trusts is December 31. The filing deadline for a trust's income tax return is 90 days after its year end (i.e. the end of March each year). When a charitable gift is made in an alter ego or joint partner trust, the donation receipt is only issued when the gift is actually completed. As mentioned above, there is no carry back and the donation tax credit can only be used in the year the gift is completed and the five years thereafter. Thus, it is important to time the gift so that the donation tax credit can be used to effectively offset income tax payable by the trust. As the deemed disposition of the trust property on the death of the relevant individual (i.e. the Settlor or the Settlor's spouse) often gives rise to a tax liability, the donation must be made in the same year as that disposition in order to permit the donation tax credit to be used to offset the resulting tax liability. Where the relevant individual dies early in the year, there will usually be sufficient time to complete the gift. However, if the individual dies late in the year, the trustees of the trust will need to complete the gift quickly in order to use the donation tax credit. If the gift is not completed in the same year the relevant individual dies, although the donation tax credit in the trust can be used to offset tax in the trust in the five years following, often there is either very little tax for the trust to pay on an ongoing basis or more

[24] Section 118.1(4) of the ITA.

[25] See the definition of "total charitable gifts" in section 118.1 of the ITA.

commonly, the trust is wound up shortly after the death of the relevant individual and the utility of the donation tax credit is lost[26].

(f) *Gift vs. Distribution?*

The most significant issue that arises when making a charitable donation in an alter ego or a joint partner trust is to ensure that the trust agreement is properly drafted to ensure that the gift to charity will be considered a donation and not a distribution to a beneficiary.

In order to appreciate this issue, it is useful to compare the CRA's position regarding donations in wills versus trusts. When a gift is made in a will, the gift is generally deemed to have been made by the deceased individual immediately prior to death[27]. The effect of this is to allow the donation tax credit in respect of the gift to be claimed by the deceased in his or her terminal tax return. However, sometimes the donation tax credit cannot be claimed by the deceased if the gift is considered to have been made by his or her estate[28]. This would generally occur where the executor/trustee has discretion as to the quantum of a gift to charity[29]. Thus, if a will directs the executor/trustee to make a gift to charity X in an amount to be determined in his or her absolute discretion, the CRA will generally view the gift to have been made by the estate not the deceased. The result is that there may be a mismatch between the tax liability payable in the deceased's terminal return and the donation tax credit which can only be used by his or her estate. This may be desirable for post mortem planning reasons but if the intention is that the donation tax credit would be used to offset the tax arising from the deemed disposition on the individual's death, then care must be taken to ensure that the discretion that is given to the executor/trustee is limited appropriately.

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[26] As noted in the previous section, the donation credit cannot be transferred from a trust to an individual or vice versa.

[27] Section 118.1(5) of the ITA.

[28] The estate is a trust and is a separate taxpayer.

[29] CRA takes the position that if the will specifies a specific amount and provides a list of charities and gives the executor/trustee discretion as to how to allocate the amount among the charities, that is a gift pursuant to section 118.1(5) of the ITA. As well, if the will provides a specific amount and does not name any charity but gives the executor/trustee the discretion to choose which charity to benefit, that will also qualify as a gift by will pursuant to section 118.1(5) of the ITA: see document 2001-0090205. However, if the will provides that the trustee has discretion as to the *amount* of the gift, the gift is not a donation by the deceased pursuant to section 118.1(5) but may be a donation by the estate if the trustee also has discretion as to which charity to benefit.

In contrast, in order to make an effective charitable gift through an alter ego or joint partner trust, the opposite approach must be taken. In order to effectively make a gift through such trusts, significant discretion must be given to the trustee. The distinction between a trust agreement giving the trustees the power to make a charitable gift and requiring them to make a gift is crucial. If a specific charity is named in an alter ego or joint partner trust agreement as a beneficiary after the death of the Settlor (or the survivor of the Settlor and the Settlor's spouse in the case of a joint partner trust), the CRA has indicated that it might not consider the gift to a charity to be a donation but rather a distribution to a beneficiary. If the gift is considered a distribution to a beneficiary, the result is that there will be *no* donation tax credit available to the trust for that gift[30]. The CRA's policy has generally been that in order to be a true "gift", it must be a voluntary transfer of property[31]. Arguably, if a charity is named as a beneficiary in a trust agreement, it can demand that the trustee distribute the property to which it is entitled. If the decision to donate is a purely discretionary power held by the trustee, no charity can demand that a distribution be made[32].

In order to ensure that a gift in an alter ego or joint partner trust is not viewed as a distribution but rather as a donation, there are two important considerations. First, the trust agreement must include a general power to donate trust property. Second, the trustee should be given full discretion after the death of the Settlor (or the death of the survivor of the Settlor and the Settlor's spouse in the case of a joint partner trust) as to (1) whether to make a charitable gift, (2) which charities to benefit and (3) the quantum of any gift. These three aspects together will ensure, to the extent possible, that the gift will be viewed by the CRA as a gift for which a donation tax credit is available. Thus, an alter ego trust that provides for a $10,000 gift to charity X on the death of the Settlor would be viewed by the CRA as a distribution to a beneficiary and no donation tax credit would be available to the trust[33].

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[30] See CRA documents 2000-0056625,2003-0182905, 2003-0015041E5, 2004-0060621E5 and 2004-0060271R3.

[31] See IT-110R3 paragraph 3.

[32] For an interesting discussion and practical example of the problems that can arise in making gifts through wills and trusts, see "Making Donations through a will or trust: Struggling with CRA Interpretations" (2004), *Step Inside*, Vol 4, No. 1, 2004

[33] Although ironically, if such a gift were contained in a will, it would be considered a gift made by the deceased for which a donation receipt could be issued.

As specific charities generally cannot be named as beneficiaries in the trust agreement, a Settlor may wish to consider executing a letter of wishes outlining the charities he or she would like the trustee to benefit. While it is not legally binding, such a letter is morally persuasive and particularly where a financial institution is the trustee, a letter of wishes can provide much needed direction.

Even if the gift to the charity is not considered by the CRA to be a donation but rather a distribution to a beneficiary, if the charity is an income beneficiary of the trust, after the death of the Settlor (or the Settlor's spouse in the case of a joint partner trust), it may still be possible for the trust to deduct the income distributed to the charity. The income distributed would not be taxed in the trust's hands and since the income would be considered to be that of the charity (which is tax exempt), no tax would be payable on that amount. However, this deduction will not be available to provide relief against the tax arising as a result of the deemed disposition of the trust property on the death of the Settlor (in the case of an alter ego trust) or the survivor of the Settlor and his or her spouse (in the case of a joint partner trust)[34].

Given the care that is required to properly make a charitable gift in an alter ego or joint partner trust, it is essential that specialized advice be sought to ensure that the trust agreement is drafted to permit the charity to issue a receipt.

(g) *Charitable Remainder Trusts*

It is possible to draft an alter ego trust or joint partner trust in which the Settlor (and the Settlor's spouse in the case of a joint partner trust) is entitled to the income of the trust but is not entitled to any capital. In these circumstances, if a charity is named as the residual beneficiary of the capital of the trust after the death of the Settlor (or the Settlor's spouse in the case of a joint partner trust), the amount of the gift is ascertainable and capable of being valued and the Settlor will likely be viewed as having made the gift at the time the trust is created and may claim the donation at that time. If section 75(2) applies to the trust, in the first five years of the trust, this donation tax credit may assist the Settlor in offsetting tax payable on income that is attributed back to him or her from the trust. Whether this is significant will depend on the income of the

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[34] Section 104(6) of the ITA provides that a trust is entitled to deduct income distributions to a beneficiary. However, there is an exception to that rule such that a trust is not entitled to deduct from its income amounts which have been deemed to have arisen by virtue of a deemed disposition of property under section 104(4).

Settlor. Unfortunately, this donation tax credit cannot be used to offset the more significant tax liability that arises on the death of the Settlor (in the case of an alter ego trust) or the survivor of the Settlor and the Settlor's spouse (in the case of a joint partner trust). For this reason, establishing charitable remainder trusts in alter ego and joint partner trusts is of limited utility from a tax saving perspective.

9. CONCLUSION

With growing concern over probate fees and challenges to a person's will, the use of alter ego and joint partner trusts has greatly increased, particularly in those jurisdictions where those issues are significant. Alter ego and joint partner trusts offer non-tax estate planning benefits and it is these benefits that are usually the driving force behind a client establishing such a trust. Nonetheless, there are technical rules associated with these trusts and it is essential that the client appreciate these when establishing such a trust. For this reason, anyone who is considering establishing an alter ego or joint partner trust should have specialized advice regarding the establishment of such trusts and the tax implications of doing so. From a gift planning perspective, this is particularly important so as to ensure not only that the client's estate planning objectives are met, but that any gifts to charity are properly structured to give maximum benefits to all parties involved.