JOINT TENANCIES

AVOIDING SOME OF THE PITFALLS

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INTRODUCTION

Joint ownership of property is not a recent innovation in our law. It is not uncommon for spouses and family members to hold property as “joint tenants”\(^1\). With the current high rate of probate tax,\(^2\) joint ownership is often considered as a technique to reduce or avoid probate tax payable on death. However, transferring property into joint ownership gives rise to many issues which, if not addressed, may create a trap for the unwary; a trap which at the end of the day may cost more than the probate tax which was saved. The purpose of this bulletin is to discuss the various tax related and non-tax related implications of this “trap”.

NON-TAX RELATED IMPLICATIONS

(i) Loss of Control

The most obvious non-tax related implication is the loss of control once property that is owned solely is transferred into joint tenancy; the original owner will no longer have total ownership and control over that property. For instance, it cannot be sold, or restored to the name of the original owner, without the consent of the new joint owner. If the property is sold, there is no guarantee that the proceeds will be the property of the original owner notwithstanding that this may have been the understanding of the original owner. This is most often demonstrated in the context of transfers between parent and child.

While joint ownership does ensure the retention of equal ownership rights and thereby prevents an eviction of the original owner (in the context of real property such as a home or the family cottage) or a disposition of the original owner’s interest without his or her knowledge, it presents other complications and considerations. For instance, in the context of a cottage property these considerations would relate to access to the cottage, the shared use and occupation of the cottage, how the responsibility for the payment of expenses might be shared and under what circumstances the property can be sold and mortgaged or the joint tenancy severed. To avoid conflict over such issues, it is suggested that they be addressed in an agreement among the joint owners.

It is important to note that a joint tenancy can be severed by a unilateral act on the part of either joint tenant. A severance creates a tenancy in common, giving each titled holder an undivided 50% interest in the property (in the case of two joint owners), which can be dealt with independent of the other tenant in common. Thus, if a parent and child own the family cottage as joint tenants and the child severs the joint tenancy and sells their interest, the parent could ultimately find that he or she becomes co-owner with a stranger. Not only might this create personal and practical issues, it would also be partially ineffective as a probate planning technique since probate tax would still be payable on the parent’s undivided 50% interest.

(ii) Consideration of Estate Plan

Another non-tax implication is how a transfer of property into joint tenancy fits into the overall estate plan of the original owner. Since the assets transferred into joint tenancy will not form part of the original owner’s estate and will not be dealt with according to the terms of the original owner’s Will, care should be taken to ensure that the transferred assets into joint names will not
defeat the purpose of the original owner’s estate plan. If the surviving joint owner is not the sole beneficiary of the residue of the original owner’s estate, the distribution of the original owner’s assets on his or her death may not be what he or she intended.

Further, if the asset transferred into joint tenancy has accrued capital gains, the surviving joint tenant may receive a greater share of the deceased original owner’s assets than was intended. This is because on death, there may be tax exigible on the accrued capital gains. These taxes are payable by the estate and thus are borne by the residuary beneficiaries under the Will but the property is not in the estate to satisfy the tax liability. This is so even though title to the property passes automatically to the surviving owner. For example, consider an individual who has transferred a major piece of real estate held for investment purposes into joint tenancy with a son, while the remaining assets of his or her estate are to pass to a daughter under his or her Will. Assume the value of the real estate is $1,000,000 and the accrued capital gains and recapture of capital cost allowance on one-half of the real estate will result in a tax liability of $400,000. Assume the residue of the estate is also $1,000,000. Since the $400,000 liability is a debt of the estate, the net residue available for the daughter is only $600,000 while the son receives the real property by right or survivorship, with no reduction for taxes. Unless the properties are equal in value and tax consequences (which is unlikely), one child can (and often does) ultimately receive a significantly different benefit than the other.

It is also important not to lose sight of the fact that if probate tax planning is the motive for transferring property into joint tenancy, the order of deaths will have the utmost importance. If the new joint owner dies before the original owner, sole title will vest in the original owner by right of survivorship, putting him or her in exactly the same position as before the original transfer, except that they may have also unnecessarily triggered some income taxes at the time of the transfer.

(iii) Equal Treatment Among Multiple Joint Owners

Joint tenancy may not deal with the situation where there are a number of joint tenants. For example, when transferring assets into the joint names of children, it is important to bear in mind that a joint tenancy will ultimately benefit only the surviving joint owner and his or her heirs, leaving no interest for the family of the other joint tenants who just happen to die first. While there are methods to implement an equalizing benefit in such circumstances, this is something that should be addressed at the time of the original transfer. If this potential result is not addressed, the effect will be to disinherit the heirs, such as children, of a deceased child from a share of the jointly owned assets; a result that might have been avoided had the asset fallen into the estate to be distributed in accordance with the terms of the original owner’s Will.

(iv) Family Law Act Considerations

No change of ownership of any property should take place before the original owner has carefully considered the implications of the Family Law Act (the “FLA”). The following are but some of those considerations.

If the property qualifies as the original owner’s matrimonial home, he or she may not dispose of it, including by way of gift, without the consent of his or her spouse. If the property is transferred
into joint tenancy with one’s spouse, the property will not be able to be returned to the original owner without the spouse’s consent. If the original owner predeceases his or her spouse and if the surviving spouse makes an election under the FLA to receive his or her entitlements under the FLA as opposed to under the Will\(^4\), the surviving spouse will receive the property by right of survivorship in addition to his/her equalization payment.\(^5\)

In the context of a joint tenancy arrangement with a child, it is necessary to keep in mind that the joint tenancy interest the child receives is “property” of the child and therefore possibly subject to inclusion in the calculation of his or her net family property in the event of marriage breakdown. While certain protections are provided with respect to any property interest that is gifted to a child after his or her marriage, this protection will be lost if the property qualifies as the child’s matrimonial home. For instance, in the context of a cottage property, if the child and his or her spouse use the cottage property as a recreational property it will likely be considered to be a matrimonial home. One option to protect the property from any claim by the child’s spouse on marriage breakdown, is to ensure that the child enters into a domestic agreement with his or her spouse, excluding the property from the net family property calculation. This is particularly important where the interest in the property was gifted prior to the date of marriage of the child.

A further point to be aware of in the context of the FLA is that where a spouse dies owning an interest in a matrimonial home as a joint tenant with a third person and not with his/her spouse, the joint tenancy is deemed to be severed immediately before his or her death. Consider the situation of a parent transferring a cottage property to two children as joint tenants, both of whom are married and the cottage qualifies as a matrimonial home for both. On the death of one child, the joint tenancy is severed and the child’s one-half interest will fall into his or her estate to be administered under the term’s of his or her Will or under the rules of intestacy. The cottage property may end up benefiting persons the parent did not intend, such as the deceased child’s spouse.

(v) Other Creditors

Transferring assets into joint tenancy will expose those assets to the claims of creditors of the new joint owner. If the new joint owner becomes insolvent or declares bankruptcy, the property can become embroiled in creditor proceedings.

(vi) Creating Potential Claims After Transferor’s Death

One other non-tax complication to bear in mind when considering changing ownership to joint tenancy, particularly in the context of inter-generational transfers, is whether this will lead to conflicts after the original owner’s death - conflicts which usually result in costs that far outweigh the probate tax savings. Consider the usual context of a child looking after the affairs of a frail, elderly parent, where the advantages of joint ownership of property, such as bank accounts and investment portfolio accounts, is fairly obvious.

In the context of changes of ownership to joint in order to allow for added convenience,\(^6\) the potential for conflict arises because the child often considers that he or she is the sole owner of the bank/investment accounts or real property in issue, as the child believes that was what the parent intended all along. Not surprisingly this conclusion is often challenged when there are
other siblings or other family members the parent would benefit under their Will or on an intestacy if the joint assets formed part of the deceased parent’s estate. What was originally undertaken because of convenience and probate tax savings is now splitting a family apart and costing avoidable legal fees.

**TAX RELATED IMPLICATIONS**

In addition to the non-tax implications of transferring assets into joint tenancy, there may be adverse tax implications which should be considered before changing ownership to property.

(i) **Acceleration of Tax**

While it is possible to reduce the value of an individual’s estate for probate tax purposes by changing ownership of property into joint tenancy, doing so is considered a disposition for income tax purposes. An inter vivos disposition in a non-arm’s length situation may give rise to immediate tax consequences if the property being disposed of is capital-property or inventory and assuming the new joint owner is not the spouse of the original owner. Revenue Canada takes the position that the original owner has disposed of one-half of his or her interest in the property for proceeds equal to 50% of the fair market value of the property with the cost of the property being 50% of the cost paid by the original owner for the entire property; any accrued capital gains and recapture of capital cost allowance will be deemed realized. Further, notwithstanding that on death the right of survivorship results in the surviving joint tenant owning the entire property and not a partial interest in the property, on the death of the original owner he or she will be deemed to have disposed of the 50% interest retained by him/her; again, any accrued capital gains and recapture of capital cost allowance will be deemed realized.

(ii) **Attribution Rules**

The transfer of property to a spouse or related minor either directly or indirectly brings into play a consideration of the possible application of the attribution rules.

While a transfer of property to a spouse either outright or in joint tenancy can be effected on a tax-free basis, any income or loss or capital gains or capital losses of the spouse from the property or from property substituted therefor is deemed to be that of the transferor.

If an interest in property is transferred directly to a person under the age of 18 years and who does not deal at arm’s length with the transferor or is a niece or nephew of the transferor, in addition to possible tax on the disposition of the property, there is attribution of income and losses (but not capital gains or losses) back to the transferor while the transferor is alive and a resident of Canada and the transferee is a minor. Thus, if the property is Canada Savings Bonds, the interest income after the transfer will be attributed to the transferor.

(iii) **Who Bears the Tax Burden?**

As already noted, an unfair tax burden may result upon the death of a joint owner of appreciated property if one beneficiary is a joint owner of property with the individual while a different beneficiary will inherit the individual’s estate pursuant to his or her Will. This stems from the fact that any income tax liability arising in respect of the deemed realization of the joint property
on the individual’s death is borne by the beneficiaries of the residue of the individual’s estate, while the beneficiary who is the surviving joint owner receives the joint property tax free. This will reduce that portion of the individual’s estate available to the beneficiaries under his/her Will.

(iv) Land Transfer Tax

The final tax implication is that if a parent changes real property that is subject to a mortgage to a joint tenancy arrangement with a child, land transfer tax will be exigible.

CONCLUSION

There has been a noticeable increase in transfer of title to assets, particularly the family cottage, bank accounts and investment portfolios, into joint tenancy, often being effected by individuals without the assistance of professional advice. Many estate plans are being influenced by the perceived need to reduce or eliminate probate taxes without considering other factors such as what the individual actually wants to do with his or her estate. Complicated transfers of property into joint tenancy may avoid probate taxes at an initial level or result in the convenient administration of one’s estate as one ages. However, the transfers may create unforeseen tax consequences and eliminate or reduce the ability of the individual to later change his or her mind as to the ultimate recipients of his or her property.

FOOTNOTES

1 The most understood aspect of owning property with another(s) as joint tenants is the right of survivorship: on the death of the first joint owner, the entire interest vests in the survivor(s).
2 Probate tax (or Estate Administration Tax) is applied at the rate of $5 per $1,000 of value for the first $50,000 of value and $15 per $1,000 of value thereafter, with no maximum.
3 On death, a taxpayer is deemed to have disposed of all capital property and inventory, with the result that there is a deemed realization of accrued capital gains and recapture of capital cost allowance.
4 It is beyond the scope of this bulletin to discuss a surviving spouse’s entitlement under the FLA on the death of the first of the spouses to die. In general, the surviving spouse has the right to receive the same entitlements on death as he or she would receive if the spouses were separating or divorcing.
5 Net family property refers to the statutory formula to calculate a spouse’s net worth for purposes of the property division scheme imposed by the FLA.
6 If convenience is the factor for implementing a joint ownership arrangement, an alternative to consider is a continuing power of attorney.