Joint Accounts: What You Need to Know!

Establishing a joint account may seem like a great strategy at first glance. However, there are many factors that must be considered before taking this action. This article will explore the use of "joint accounts with rights of survivor" and the related estate planning, control and tax issues and consequences.

What Are Joint Accounts?

There are two types of joint accounts and details of each are highlighted below.

Joint Accounts with Right of Survivorship

Two or more people (tenants) own the assets that are held in this type of account. All individuals listed as joint tenants in a joint account WROS have equal ownership and control of the assets. The parties do not have to be related, however, often they are spouses or parents/children. Upon the death of one of the tenants, the remaining tenants automatically receive ownership of the deceased tenant's portion of the assets.

It should be noted that this type of ownership is not available in Quebec.

Joint Accounts with Tenancy in Common

With tenancy in common arrangements, each tenant may or may not own equal parts of the assets. When a tenant in common passes away, their share is left to their beneficiaries and not to other tenants in common. This type of account is not usually used for estate planning purposes as assets with this type of ownership are usually subject to probate fees.

Why Open a Joint Account WROS?

With a joint account WROS in place, administration of the estate becomes a lot easier because the "right of survivor" allows for the assets in the account to pass directly to the surviving tenants upon the death of one of the tenants. This results in the assets essentially bypassing that individual's estate.

For this reason, a popular justification for opening joint accounts WROS is to avoid having to pay probate fees upon the death of one of the account holders. Without a joint account in place, these assets would become part of the estate and probate fees of a maximum of 1.5% (probate fee in Ontario – fees vary from province to province) would have to be paid before the estate assets could be distributed to beneficiaries.

For example, assets of $100,000 held solely by an individual would be subject to $1,500 of probate fees upon the death of that individual (1.5% * $100,000). The same $100,000 in assets held in a joint account WROS would not be subject to any probate fees, as they would pass directly to the joint tenants upon the death of the individual.

Implications of Setting Up Joint Accounts

Setting up a joint account WROS will have the following ramifications:

- control of the assets will belong equally to all tenants
- a deemed disposition of the portion of the assets may or may not be necessary for tax purposes
- reporting of any income derived from the assets (interest, dividends or capital gains) after the account ownership is changed from individual to joint may or may not change

Control

One of the attributes of a joint account, and one which all tenants must be made aware of, is that any joint tenant is able to withdraw funds from the joint account at any time and does not need the permission of the other tenant(s) to do so. As well, any creditors of a tenant have the right to the interest of that joint tenant in the asset.

This issue raises many questions that should be addressed before setting up this type of account. For example, in many cases, spouses may be comfortable with this arrangement now, but what if they were to experience marital problems a few years down the road? Would each spouse still be comfortable with the arrangement then? In the case of parents and children, is the parent ready to give up full control of his or her account to a son or daughter? What if that son or daughter was to experience marital problems of his or her own?

Tax Implications – Deemed Disposition and Income Consequences

The tax implications of setting up joint accounts are different if they are set up with adult children or spouses. A discussion of each scenario follows below.

Setting up a Joint Account with an Adult Child (over 18)

When the joint tenant is an adult child, and the parent owns all of the existing assets, there will be a deemed sale of a portion of the assets at their current value at the time the ownership of the account is changed. For example, if three adult children became joint tenants with a parent, ¾ of the asset would be deemed sold by the parent. If the asset had appreciated in value the parent would owe taxes in the current year.

As an illustration, assume the $100,000 in assets discussed above was to be set up in a joint account WROS with three adult children. This would result in an immediate deemed disposition by the parent of $75,000 (75% of the assets). This is the FMV (Fair Market Value) of the portion of the assets deemed being sold. If the assets were purchased at $20,000, the ACB (Adjusted Cost Base) to be used for the purposes of this deemed disposition would be $15,000 (75% of $20,000).

The total capital gain to the parent is $75,000 FMV less $15,000 ACB= $60,000. The taxable portion of this capital gain is 66.66% (post February 29, 2000 federal budget) which equals $40,000 and if this individual was in the highest tax bracket, approximately $20,000 in tax would be owed.

The trade off in this situation then becomes the $1,500 in probate fees ($100,000 * 1.5%) that will no longer have to be paid in the future vs. the $20,000 in tax that must be paid immediately. This must be factored in to the decision, as must the tax consequences and control issues going forward.

Note that in the case of bank accounts, GIC's, T-bills or similar fixed income investments there would no tax consequences as a result of a "deemed disposition" as these assets are not appreciating capital assets/growth assets.

In either case discussed above, both future capital gains and losses on the assets, and any future income on the assets would be reportable proportionately for tax purposes (i.e. 25/25/25/25 in the case of the parent and the three adult children). Any subsequent capital gains or losses on the adult children's share of the portfolio would not be attributed back to the parent.

Setting up a Joint Account with a Spouse

If a joint account is set up with a spouse, the tax consequences of a deemed disposition are avoided by transferring ownership of the assets at the adjusted cost base (instead of at FMV). In this situation, tax on the appreciated value of the asset can be deferred until the asset is actually sold. At that time, the

gains would be attributed back to the spouse who contributed the assets to the account.

Reporting income on joint accounts owned by spouses seems to cause many misconceptions. Although an asset may be a joint account for legal purposes, Canada Customs and Revenue Agency (CCRA – formerly Revenue Canada) looks to beneficial ownership and not legal ownership when determining who should pay tax on any income generated in the account. So, although a married couple may have a "joint account", income or growth is to be reported for tax purposes according to the proportion of funds that each spouse contributed to that account.

Many individuals are under the false impression that they can transfer assets in to joint name with a spouse primarily for the purpose of income splitting (transferring income to family members in lower tax brackets to achieve overall tax savings). While legitimate income splitting techniques are available, placing assets in joint name with a spouse is not one of them as the CCRA simply classifies this action as gifting.

The attribution rules prevent an individual from transferring assets to a spouse (or child under 18) and attempting to report any dividend or interest income derived from that asset in the recipient's name (presumably at a lower tax rate). As noted above, even capital gains realized by a spouse on the subsequent sale of transferred property will be attributed back to the transferor spouse for tax purposes.

The only situations in which attribution of taxable income does not apply in a joint account are:

- ones in which an outright gift is made to an adult child over the age of 18 as discussed above (note : deemed disposition still occurs – just not attribution),
- ones in which fair market value consideration was paid by the recipient spouse and the rollover in to the joint account was elected to be done at FMV, or
- ones in which both (all) tenants contributed an equal value property in to the account when it was first established (note: this would also avoid the deemed disposition in all cases).

Conclusion

While avoiding probate may seem like a great objective, individuals must be aware of the deemed distribution and attribution rules and must completely understand the control implications of establishing joint accounts. The end result is really a trade off between reducing probate fees and a combination of tax consequences with sharing of control issues.

For this reason, transferring assets into joint ownership should never be done without professional tax and legal advice.

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