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Tax Topics

from Manulife's Tax & Estate Planning Group

Joint Ownership and Life Insurance Considerations

Introduction
There are many issues to consider before property of any kind is put into a joint ownership arrangement with family members or otherwise. Life insurance and investments have particular intricacies that should be considered before joint ownership is arranged. This Tax Topic will review the legal and tax attributes of joint ownership and how those attributes apply to a jointly owned life insurance policy

What is joint ownership?
Generally there are two ways in which to own property: tenancy in common or as joint tenants. A life insurance policy is no different than any other type of property and can be owned either under a joint tenancy arrangement or as tenants in common. Depending upon the carrier, ownership if not noted on the application as either a joint tenancy arrangement or as tenants in common may default to one or the other. Therefore, confirming with the carrier as to what might be the default setting for ownership is always recommended so as to ensure that there are no surprises as to ownership.

Who should own a policy depends on the facts of the situation. A number of questions must be considered to determine where the insurance should be owned. To assist in making this determination reference should be made to the guide "Life Insurance Ownership: A Guide for Professional Advisors".

The distinction between the two types of ownership arrangements will be considered in more detail below.

Tenancy in common
Tenancy in common is a form of ownership whereby each owner holds an undivided interest in the property. The interest of a tenant in common does not terminate upon his or her death. While there is a unity of possession, each owner has separate and distinct title to their interest in the property. By way of example, if A and B have acquired real property as tenants in common and both have contributed to the purchase price equally, upon A's death, A's one-half interest in the property shall pass to A's estate or A's heirs. The tenant in common owner owns a percentage interest of the property; this interest can be severed, portioned or sold.

Joint tenancy
Joint tenants have one and the same interest in the property. Unlike tenants in common, upon death of one of the owners, there is a right of survivorship in the interest by the other owner. The interest of the deceased joint tenant owner does not pass through his or her estate and the interest is therefore not distributed pursuant to the terms of the will, or, in the case of intestacy, will not be subject to the intestacy laws. As a consequence, the surviving owner will become the sole owner of the property. For example, if A and B purchase a property together as joint tenants and contribute equally to the purchase price, upon the death of A, A's interest will revert to B so that B owns 100% of the property. Since the interest does not flow into A's estate, there would be no applicable probate fee. As a result, joint tenancy may be appealing in provinces such as Ontario and British Columbia where probate fees are particularly high and are often considered in the estate planning context.

The four unities required for a joint tenancy arrangement are: unity of possession, unity of interest, unity of title and unity of time. While the four unities have guided the court in determining whether a joint tenancy arrangement exists, the Supreme Court of Canada (the "Court") reviewed two cases that provide further discussion on determining if the legal consequences of joint ownership will always result.

In the Pecore v. Pecore, 2007 SCC 17 and Madsen Estate v. Saylor, 2007 SCC 18, cases a father put bank and investment accounts into joint names with a daughter. The Court examined the cases from the perspective of modern times where children are often named jointly on accounts to assist elderly parents with their financial management and for estate planning purposes.

What has flowed from the review of the two cases by the Court is that the intention to own property jointly must be considered carefully from the evidence presented. The Court will consider the actions of the transferor, the types of documents that have been signed, who has contributed to the accounts and how the accounts are being used and for what purpose. Such evidence will assist the Court in determining the intention of the transferor. To a certain extent this may remove some certainty as to how ownership will be determined. It now depends upon the evidence before the court. For a further discussion of the two cases see As a Matter of Law "Joint Account Arrangements- Do we have a Clearer Direction from the Supreme Court of Canada?"

How joint tenancy arrangements are generally taxed?

The basic legal principle in the joint ownership context is each party owns the entire property. However, the current tax treatment of jointly held property is based on the premise that the interests of each joint owner are divisible. The divergence between the legal principle and the tax application creates an interesting outcome in the life insurance context and may cause carriers to treat tax outcomes differently.

Transferring a policy from A to A and B jointly will result in a disposition of a 50% interest in the policy at the time of the transfer unless such transfer is covered under the rollover provisions of the Income Tax Act, R.S.C. 1985, c. I (5^{th} supp.) (the "Act"). For a full discussion on how rollovers may apply see the Tax Topics titled "Intergenerational Transfer of a Life Insurance Policy" and "Transfers of a Personally Owned Life Insurance Policy". Assuming the rollover provisions do not apply, the transfer into joint ownership should be considered carefully as a taxable policy gain (T5 income) may result where the cash value of the policy exceeds the adjusted cost basis (the "ACB") of the policy.

If A and B are joint owners, then on the death of A, A's interest in the policy will pass to B by right of survivorship. Based on this legal premise, there would be no disposition at the time of A's death since A and B at the time of the creation of the joint tenancy would own the entirety of the property. However, the Canada Revenue Agency (the "CRA") in Technical Interpretation 2005-0152011E55 takes the position that upon A's death, there is a disposition of A's one-half interest in the property to B at the time.

Insurance carriers may differ on what tax treatment arises on the death of A. Some carriers may administer the policy from the perspective that a change in ownership interest will occur upon A's death, resulting in a disposition of that person's one-half interest in the policy. This treatment is consistent with CRA's current position. Alternatively, others may treat the entire policy as being disposed of at the time of death and then reacquired. This position is easier to administer to since the policy owners are viewed as having one interest and one ACB and the adjustment therefore does not require the tracking and splitting of the ACB of the policy. In either event, there are no tax consequences as a result of this disposition if the transfer qualifies under one of the rollover provisions under the Act.

How does joint ownership affect policy rights?

While living

One of the challenges in the joint ownership context is in making a beneficiary designation. Both owners must agree to the designation and both are required to sign in respect of making that designation. A change in the designation cannot be made without the consent and signature of the other joint owner. Therefore, both joint owners must ensure that they agree to the designation being made and will be able to reach an agreement should there be a desire to change the designation in the future.

As well, one joint owner cannot unilaterally exercise contractual rights under the policy without the consent and signature of the other owner. Both owners will have to provide consent in relation to all transactions relating to the policy. This includes any changes to investments, collaterally assigning the policy, a policy loan, or surrender of the policy. The rights of the joint owner are therefore limited by each other's ownership in the policy.

Joint tenancy arrangements cannot unilaterally be severed. There must be mutual agreement or a course of conduct which illustrates that the joint tenancy is severed. In the latter scenario, there is case law that supports the premise that instructions to a solicitor as to severance will sever the joint tenancy and that a severance can occur by one party not responding to the other party. Such was the case in Robichaud v. Watson (1983), 42 O.R. (2d) 38 (H.C.J.) and Lam v. Le Estate, (2002), 25 R.F.L. (5th) 72 (Man. Q.B.). However case law varies on this issue and the court has stated in other case law that there must be a clear intention to sever the relationship in the real property context (see Davison v. Davison Estate, 2009 MBCA 100 and O'Connor Estate v. Lindsay, 51 Man. R. (2d) 65.

Arguments that may succeed to sever a joint tenancy arrangement in the real property context may not apply to a life insurance policy contract. As discussed earlier, most insurance contracts require that both parties agree to any changes in the policy including a change in ownership.

Contract provisions may indicate what will happen to the policy when joint ownership is severed. The contract and its underlying values/funds may either be split or allocated equally to each party. The original policy may be kept in place with one owner maintaining that policy and the other owner being issued a new policy. Each situation will differ depending upon contract wording and the approach by the insurance carrier to the tax treatment.

Capacity

When joint owners both have capacity, decisions in respect of the policy can be made by both parties. However, when an owner becomes incapacitated the other owner may be left with a policy that he or she is unable to deal with. Since the consent and signature of all owners is required in relation to all policy transactions, both owners must have the capacity to provide such consent and signatures.

Often a continuing power of attorney document dealing with property will not address a life insurance policy. One practical approach to this dilemma may be to include a reference to a particular policy in the power of attorney document and grant power to the attorney to specifically deal with the policy. While this may provide a solution that allows the attorney to deal with the policy the law is unclear as to whether this would be permissible.

Where a reference to the insurance policy is not made within the power of attorney document (which is common) the applicable provincial legislation must be considered. The validity of the power of attorney document under provincial legislation requirements and the powers granted to the attorney will have to be examined. From there, the carrier will have to determine whether the document is valid and whether the powers granted to the attorney are broad enough to allow the attorney to deal with the policy.

Where no power of attorney document exists, the joint owner may simply have to appeal to interested parties of the incapacitated owner to make application to be appointed as a guardian of property, or alternatively seek their own appointment in order to deal with the policy.

After death of one of the joint owners

Upon the death of a joint owner, provincial insurance legislation generally provides that the rights and interests in the contract do not form part of the deceased's estate and the surviving owner continues on with the same rights and interests in the contract.

When a life insurance policy is owned jointly with right of survivorship, the designated beneficiary remains in place on the first death because ownership continues by the surviving owner. There is no change of ownership on death. Therefore, no change in the beneficiary designation occurs unless the surviving owner subsequently changes the designation making a new one. This can be done without the consent of the beneficiary unless the designation is irrevocable.

Often in the case where the joint owners are husband and wife, there is a concern over the ability of one spouse to change a designation that had initially been agreed to by both spouses. Arguably, one spouse may put forth that the parties agreed to the designation and based on a contractual arrangement the designation should not be changed. While there is analogous case law in the wills context to support this argument (see the case of Hall v. McLaughlin Estate, 2006 CanLII 23932 (Ont. S.C.J.), it is unclear whether this would apply in relation to a beneficiary designation where the policy was jointly owned and has subsequently passed by right of survivorship to one of the joint owners.

In order to avoid a change by the surviving owner after the death of the other joint owner an irrevocable beneficiary designation may be made initially. This of course also puts limitations on the joint owners to deal freely with the policy, as the irrevocable beneficiary would have to provide consent to such things as changing or altering the beneficiary designation, assigning the policy, withdrawing funds from the policy, transferring the policy or changing the policy coverage.

What happens upon simultaneous death?

There may be situations where one or both joint owners are not the insured under the contract (for example, where parents jointly own a policy on the life of a child). In this scenario, if a contingent or successor owner is not named under the policy, then provincial legislation determines ownership of the policy. For instance, the Ontario Succession Law Reform Act, R.S.O. 1990, c.S. 26, indicates that with the simultaneous death of joint tenants, unless a contrary intention appears, property is deemed to be held as tenants in common (resulting in the interest being severed at death). Unless the carrier indicates otherwise in the terms of the contract, the contract would be subject to the applicable provincial legislation where the contract was formed.

What planning opportunities are available?

Estate planning

One of the main reasons why property is put into joint ownership is for estate planning purposes. Where property is owned as joint tenants, it passes by way of survivorship and therefore does not form part of the estate of the deceased and is not subject to probate fees. In the province of British Columbia joint tenancy arrangements may be preferred due to the Wills Variation Act, R.S.B.C. 1996, c. 490, legislation in that province. The asset would be owned by the survivor and not fall under the will. However, the ownership of the asset may still be subject to challenge by making a trust argument under the common law.

As discussed earlier, a life insurance policy will pass to the survivor but this may also trigger a taxable disposition of the policy unless the rollover provisions apply. It will however, not be subject to probate fees.

From an administrative perspective, it is easy for the surviving owner to deal with the policy. There are few formalities for the surviving owner to deal with other than providing proper notice to the insurance carrier of the death. The transition for the surviving owner is somewhat seamless.

Creditor protection

When any property is jointly owned, each owner must realize that the property may become the subject of creditors of the other owner. While the property will not form part of the estate of the deceased owner because it passes to the surviving owner, it may during the lifetime of each owner be subject to creditors. Therefore, it is important to consider whether a joint ownership arrangement is advisable, especially in the instance where an owner is aware of potential creditor issues.

Note should however be taken in the common law provinces of Newfoundland, Ontario and Alberta of the principle that a joint bank account cannot be attacked under a garnishee order to pay a debt owed by one, but not all, of the joint holders. For a further discussion of the case law and this principle see the As a Matter of Law article “Can Joint accounts be subject to the creditors of the joint holder?”

However, in the case of an insurance policy, if a member of the preferred class is named as a beneficiary under the policy, the policy will not be subject to seizure. A member of the preferred class includes a spouse, child grandchild or parent of a person whose life is insured. In Quebec, the relationship is to the policy owner and includes ascendants and descendants. If the joint owners can agree to name an individual who falls into the preferred class, the policy will not be subject to the creditors of any joint owner. Where the joint owners are not related, this may be difficult to accomplish.

Insurance trusts

Insurance trusts are commonly used in estate planning. See also the Tax Topic on "Insurance Trusts" for a further discussion. An insurance trust is created by the owner of the life insurance policy and is not settled until the death of the life insured under that policy. At that time, the proceeds are paid into the insurance trust on and as a consequence of death of an individual and are held and ultimately distributed in accordance with the trust provisions. To qualify as a testamentary trust under subsection 108(1) of the Act, the trust must not be created by a person other than an individual. Given this requirement, the question arose as to whether an insurance trust in respect of a joint-last-to-die policy on the lives of the two joint owners can qualify as a testamentary trust. If not considered to be a testamentary trust, this would be particularly costly from a tax perspective as the trust would lose the benefit of the graduated rates of taxation each and every year of the trust's existence.

A CRA Technical Interpretation (#2008-0270421C6, Question #5, from the CALU CRA Roundtable) has addressed this concern. The technical interpretation indicates that in the case of a joint-last-to-die life insurance policy where the only amount that is payable to the trust under the policy is paid on the death of the last of the two persons insured under the policy, then a testamentary trust would still exist. Therefore a jointly owned joint-last-to-die policy would be permissible,however any amounts payable on a first death would be problematic. For a more in-depth discussion of joint ownership issues and planning with insurance trusts see the Tax Topic "Insurance Trusts".

Conclusions

While a joint tenancy arrangement is often used for estate planning purposes, such ownership should be considered carefully. There can be benefits and opportunities but there are also many issues and considerations that should be understood before placing property into a joint ownership arrangement.

A life insurance policy owned by joint tenants has its own intricacies to consider, as do investments and bank accounts. Understanding the issues associated with such arrangements will ensure that when a joint tenancy arrangement is put in place it is done for the right reasons and will provide the appropriate outcome.

The Tax & Estate Planning Group at Manulife Financial write new Tax Topics on an ongoing basis. This team of accountants, lawyers and insurance professionals provide specialized information about legal issues, accounting and life insurance and their link to complex tax and estate planning solutions.

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