TAXADVISOR

Disjointed Rights – Part Two

A second decision on joint accounts pursues their intention, as opposed to what they should have known

COURT REPORT

BY JAMIE GOLOMBEK

In last month's column, we discussed the first of two Ontario Court of Appeal cases (*Pecore v. Pecore*, 2005 CanLII 31576 (ON C.A.)) involving joint accounts that will heading to the Supreme Court of Canada this December.

This month we will be discussing *Saylor v. Brooks*, (2005 CanLII 39857 (ON C.A.)), which surprisingly came to a different decision than *Pecore*, despite having very similar facts.

THE FACTS

The late Michael Madsen had three children: Mary Saylor, William Madsen and Patricia Brooks. Patricia Brooks was named as the sole executor of her father's estate.

Prior to Madsen's death, he transferred all of his bank and investment accounts into joint names with his daughter, Patricia.

In December 1998, Madsen died and as a result, the assets in the joint accounts were transferred directly to Patricia in her capacity as the surviving joint owner of the accounts.

William Madsen and Mary Saylor sued their sister Patricia in her capacity as estate trustee, claiming that their father never intended the transfer of the joint accounts to be a gift to Patricia alone but rather intended to retain both full legal and beneficial ownership of the accounts.

The distinction is important because if Patricia is found to be the recipient of a gift made by her late father, then the assets in the joint accounts do not devolve to the estate and therefore belong to Patricia alone, by right of survivorship.

If, on the other hand, it's determined that no gift was made at the time of transfer and that her name was put on the account simply as a matter of convenience, the assets in the joint account would form part of the estate and thus her siblings would be entitled to inherit their representative portions of the accounts, under their late father's will.

> The assets in the joint accounts had to be returned to the estate and divided in accordance with Madsen's will.

THE DECISION

The appeal court reviewed all the facts and evidence in the case, namely: The late Madsen controlled the accounts during his lifetime, he claimed all the income annually for tax purposes and Patricia, although a joint owner, never deposited any new money into the account and only withdrew money upon her father's directions. In addition, there was evidence that Madsen said that he might remove his daughter as a joint owner should he decide to remarry.

As a result, the majority concluded that "the father put the bank accounts in both Mrs. Brooks name and his own solely for convenience." The court therefore found that at the time of transfer, the joint accounts were not intended as gifts but rather were intended to be included as part of the estate. As a result, the court ordered that the assets in the joint accounts had to be returned to the estate and divided in accordance with Madsen's will.

IRRECONCILABLE DECISIONS

The result in *Saylor* is surprising given the *Pecore* decision discussed in this column last month in which an opposite conclusion was reached with a very similar set of circumstances. Several of these inconsistencies were pointed out by Justice Feldman in her published minority dissenting opinion in the current case.

As a refresher, in *Pecore*, the father put about $1 million into a joint account with his daughter Paula, one of his three adult children. After he died, Paula's husband separated from her and found out that he may have been a beneficiary under his ex-father-in-law's estate. He then sued for a portion of the joint account, arguing that those funds should have formed part of the estate.

In *Pecore*, the court also looked at the facts in an attempt to determine what the father's true intention was at the time he transferred his assets into joint ownership with his daughter. The court found that the father was familiar with the concept of joint ownership and was cognizant of the fact that any assets he put into joint name would ultimately pass to his daughter, the joint owner. After all, he and his wife had held assets jointly that ultimately became his upon his wife's death.

By contrast, in *Saylor*, despite similar evidence that Madsen had also held his investments in a joint account with his wife prior to her death when they devolved to him, and that he should have therefore known that the joint assets would similarly devolve to his daughter upon his death, the majority chose not to consider this as a determinative factor in this case.

Secondly, in *Pecore*, the father gave Paula a power of attorney over his assets — something the court took as evidence that he must not have been using the joint account with Paula "as a tool of convenience to give her signing access on the account" but rather "…it showed that the father intended something more." In *Saylor*, the father also gave Patricia a power of attorney, but the majority did not view the "giving of the power of attorney as a factor that suggested that the joint account was not set up merely as a tool of convenience."

Finally, in *Pecore*, it was argued that despite the fact that the father maintained control over the investments and paid all the taxes, the court held that "[w]hile control can be consistent with an intention to retain ownership, it is also not inconsistent in this case with an intention to gift the assets. Hence, this factor was not determinative of [the father's] actual intention."

By contrast, in *Saylor*, one of the primary reasons cited by the majority to demonstrate that Mr. Madsen never intended to transfer a beneficial interest to Patricia is that he "remained in control of his finances and that he paid the taxes."

THE FINAL SAY

Ultimately, it will be up to the highest court to review these two cases to determine whether there is some way of reconciling these seemingly conflicting decisions. The SCC's guidance should prove to be very helpful for advisors in your continuing goal to properly counsel clients on the advantages and disadvantages of joint ownership. **AER**

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Securing Dividends

BY MARK BROWN

To stop corporate income taxes hemorrhaging away as corporations converted to income trusts, the federal government reduced the double taxation of dividends. But for investors to get the full tax reduction, the provinces had to follow suit. Now the Ontario government says it will fall in line with the federal program.

Queen's Park will phase in an increase to the tax credit for eligible dividends to 7.7% by 2010, starting this year at 5.13% (*see "Ontario's dividend tax credit" for a more detailed breakdown*). The measure is intended to recognize that corporations already pay tax before they pay out their dividends, unlike income trusts whose income is taxed only in the hands of unitholders.

In 2005, the former Liberal government introduced changes to eliminate this double taxation of dividends as a way to level the playing field between corporations and income trusts. The Conservatives included this idea in the spring federal budget.

If approved, Ontario says the change will bring its tax rate on dividends more in line with the effective tax rates on other forms of investment income. The tax change would be retroactive to Jan. 1, 2006. The legislation, which will be introduced this fall, could pass before the end of the year if it receives all-party support.

Only two other provinces have followed the federal rules so far, although some provinces are reportedly waiting for Ottawa's changes to be put in place before the implement their own.

In March, Quebec said in its budget it would follow the federal rules, while Manitoba made its own announcement in early June. The prairie province is proposing to increase the dividend tax credit to 11% from 5%. However, unlike Ontario, Manitobans won't have to wait until 2010 to get the full benefit since the province does not call for a phase-in period.

While the change will not put dividend-paying corporations in the province on par with income trusts, the C.D. Howe Institute, a vocal opponent of the unequal tax treatment between corporations and trusts, says Ontario is going in the right direction. "It's bringing the taxation of corporate profit distributions in the form of dividends more in line with distributions by income trusts," says Yvan Guillemette, a policy analyst with the C.D. Howe Institute.

ONTARIO'S DIVIDEND TAX CREDIT

	Large corporations Current	Large corporations Proposed
A. Income	$100	$100
B. Corporate income tax	-$31[1]	-$31[1]
C. Amount distributed to investor	$69	$69
Canadian taxable individual investor		
D. Amount included in income	$86	$100
E. Personal income tax (46.2%[2] of D)	$40	$46
F. Federal and Ontario dividend tax credit	-$18	-$31
G. Net personal income tax (E - F)	$22	$15
H. Total tax paid (B + G)	**$53**	**$46**

1. The combined federal-Ontario corporate income tax rate for 2010, including the proposed federal corporate tax rate reductions
2. The top federal-Ontario personal income tax rate

Despite these measures, Guillemette believes a number of investors will continue to favour income trusts. "All of the investors that can't take advantage of this tax break, which includes the owners of pension funds, the owners of RSPs and non-resident investors in Canadian equities. . . [will] still prefer income trusts because they avoid the corporate tax both at the personal level and at the corporate level," he says.

"It's far from making income trusts disappear or non-desirable, but it does help to move the system in the right direction." **AER**