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GUARDIANSHIP, POWERS OF ATTORNEY, TRUSTS & HEALTH INSURANCE

George and Susan are in their mid-50s, and have been married for twenty years. They both enjoy good health. But a friend of Susan's mother recently died in her early 90s from complications associated with Alzheimer's disease. Her passing has got George and Susan thinking about the purchase of long-term care and critical illness insurance policies. They also met recently with their lawyer to revisit their estate plans. While at their lawyer's office, they discussed how they should own and manage their policies if they became incapable of managing their own affairs. Let's explore the different ways in which they could own long-term care insurance (LTCI) and critical illness insurance (CII) policies.

THE INSURANCE NEEDS

If either George or Susan (or both) needed long-term care (LTC), the cost could seriously impair their retirement funds and income. Neither has a defined benefit pension plan. They are relying on their accumulated savings for a good retirement. If either or both of them ever needed LTC, they would want to make sure that they had the money to afford it, and had some choice about the level and quality of care they would receive.

George and Susan also recognize that if either were to have a critical illness, there'd be costs associated with their convalescence and recovery, and with any ongoing treatment associated with the illness. As with LTC, they understand the financial costs of recovering from a critical illness could deplete their retirement funds. They'd rather protect themselves against the financial harm that a critical illness could cause than risk their savings.

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OPTIONS FOR HEALTH INSURANCE POLICY OWNERSHIP

Many people personally own their insurance policies. Personal ownership provides control, but the owner must be capable of managing the policy while healthy, and managing the insurance proceeds if they need to make a claim. As people age, the likelihood of having a critical illness or needing LTC increases, as does the likelihood of losing the capacity to manage the proceeds of insurance.

Beyond personal ownership, there are generally three options for managing someone's property or personal care if they become incapable:

- Guardianship
- Power of attorney
- Trust (property only)

Incapacity is defined in the Substitute Decisions Act in Ontario, and in similar legislation in other provinces and territories. Incapacity to manage property occurs when a person can't understand information relevant to deciding how to manage their property, or can't reasonably foresee the consequences of a decision or of a failure to decide.[1] Incapacity for personal care occurs when the person is not able to understand information relevant to making a decision concerning their health care, nutrition, shelter, clothing, hygiene or safety, or can't reasonably foresee the consequences of a decision or failure to decide.[2]

GUARDIANSHIP

Guardianship provides a legal mechanism for allowing someone to manage a person's personal care and/or property if that person becomes incapable of managing their own affairs, and if they haven't made other or satisfactory arrangements.

[1] Substitute Decisions Act, S.O. 1992, Chapter 30, section 6.
[2] Substitute Decisions Act, section 45.

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In Ontario, the Public Guardian and Trustee (PGT) steps in when a person becomes incapable of managing their property.[3] Similar offices exist in other provinces and territories throughout Canada.[4]

In Ontario, the process begins with the incapable person or another person requesting an assessment of the incapable person. The PGT can assume control of a person's property after receiving a certificate of incapacity. It can relinquish that control to a family member who applies to become a guardian, without needing a court order. But the PGT will require the proposed guardian to submit a detailed plan showing how they will manage the incapable person's finances. The proposed guardian may also have to post a bond.

If there are no qualified family members, a judge may appoint a third party to manage the person's property. Failing that, the PGT may retain management of the incapable person's property.

The PGT doesn't have the right to manage an incapable person's personal care; the PGT also may not appoint someone to manage an individual's personal care decisions. Anyone wishing to become a guardian over an incapable person's personal care will have to apply to a judge.[5]

Applicants for guardianship (property and personal care) over an incapable person must give reasons for why the guardianship is sought, provide medical evidence as to the incapable person's incapacity (including assessments of that person's capacity from a physician or assessor),[6] and provide a detailed plan for the incapable person's care. The PGT also must approve the plan.

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[3] In Ontario the process is governed under section 16 of the Substitute Decisions Act.

[4] See for example, Alberta's Adult Guardianship and Trusteeship Act, S.A., c. A-4.2, Nova Scotia's Guardianship Act, 2002, and Adult Capacity and Decision-making Act, 2017, and the Guardianship and Trusteeship Act, S.N.W.T., 1994 in the Northwest Territories.

[5] Substitute Decisions Act, section 55.

[6] An assessor is a member of a class of persons designated by regulations passed under the Substitute Decisions Act (and corresponding legislation in other provinces and territories) as qualified to assess an individual's capacity. In Ontario the governing regulation is Ontario Regulation 460/05. In Ontario an assessor must be licensed to practice as a physician, psychologist, social worker, occupational therapist or nurse, and must have satisfied the qualifications noted in the regulations. Similar requirements exist in other provinces and territories.

A guardian doesn't assume ownership of the incapable person's property; they're also not responsible for that person's debts. A guardian is entitled to be paid for their services, but may not otherwise benefit from their office. Unless specifically authorized, they may not use their powers to transfer property to themselves.

Periodically, a guardian may have to demonstrate to a judge that they're properly managing the incapable person's property. They do that by passing their accounts (submitting them to a judge for review). The incapable person, their attorney for personal care, a dependent or creditor of the incapable person, the Public Guardian and Trustee, and anyone else the judge permits, may require the guardian to pass their accounts.[7]

George and Susan regard guardianship as a last resort, and wish to avoid putting each other, or a loved one, in the position of having to apply for guardianship. Fortunately, they can do that with advance planning.

POWERS OF ATTORNEY

A person can avoid the need for a guardianship application by providing a trusted person with a continuing power of attorney for their property and personal care.[8] The person who gives someone else power over their property and personal care is called the donor; the person who exercises that power is called the attorney. Although the term "attorney" implies the need to be a lawyer, there is actually no requirement for an attorney acting under a power of attorney to be a lawyer.

Since a general power of attorney becomes invalid on the donor's incapacity, the power of attorney document must contain specific language allowing it to continue after the donor becomes incapable (hence the term "continuing power of attorney"). A continuing power of attorney over property lets

[7] Ontario Regulation 100/96 describes the accounts that someone acting as a guardian or attorney under a power of attorney must keep: www.e-laws.gov.on.ca/html/regs/ english/elaws_regs_960100_e.htm. Similar laws exist in other provinces and territories.

[8] In a guardianship application, a judge may not appoint a guardian if satisfied that there is an alternate course of action: Substitute Decisions Act, subsection 55(2).

the attorney manage the donor's property in the same way that the donor could personally, except the attorney can't perform any testamentary acts on the donor's behalf – writing or changing a will, making a new power of attorney, or making or changing a life insurance policy beneficiary designation.

A power of attorney for personal care gives the attorney the right to make personal care decisions for the donor if the donor becomes incapable of making those decisions.[9] Such decisions would include the care and treatment of the donor following a critical illness, if the illness left the donor incapacitated (by a severe stroke, for example). If the donor required LTC, but was incapable of making decisions, the attorney could decide on the type of facility and on the level and quality of care. In their power of attorney the donor could also instruct the attorney to refuse medical treatment for the donor in certain circumstances.

A donor can limit the powers granted under powers of attorney for property and personal care, and the circumstances allowing for their use. For example, the donor may say that neither power of attorney may be used unless a physician has certified that the donor is incapable of managing their own affairs. In many cases spouses give unlimited powers of attorney to each other, but limited powers of attorney to their adult children, to use if the spouse cannot act and if the donor has become incapable.

It's possible to name the same person under both powers of attorney. For example, if Susan named George as her attorney, and became incapable of managing her affairs, George could claim benefits under Susan's LTCI policy and arrange for payment for Susan's LTC using the continuing power of attorney over property. He could also manage the decisions for Susan's care using his power of attorney for personal care.

Unless Susan placed limits on George's use of the powers of attorney for property and continuing care, George would be free to use them as soon as she signed them, and in any event, as soon as he determined that Susan was incapable of managing her affairs.

[9] Health Care Consent Act, 1996, S.O. 1996, Chapter 2, Schedule A, section 20.

A power of attorney is inexpensive and easy to create and use compared with a guardianship. But the donor must carefully choose their attorney because there is no requirement for a bond, and no formal requirement to submit accounts to a judge for review. If concerned family members or others with an interest in the donor's estate or welfare suspect that the attorney is using their powers inappropriately, they may ask a judge to review the attorney's accounts and/or remove the attorney, in which case the proceeding would need to incorporate a guardianship application.[10]

Accordingly, an attorney wanting to avoid problems must act carefully. If their right to use a power of attorney depends on the donor's incapacity, they must document that incapacity. Though many powers of attorney require a physician to perform the assessment, physicians are increasingly reluctant to perform capacity assessments from a concern that they lack the necessary qualifications. While a physician who feels competent to perform an assessment can still do one, if the power of attorney allows it, a capacity assessment can also be performed by a qualified capacity assessor (*see footnote 6*).

The attorney must review the power of attorney, noting any limitations it puts on them. They must also review the donor's will, to ensure that any actions they take as attorney won't frustrate what the donor wants to accomplish in their will.

All actions (financial and care-related) must be documented, receipts kept and notes made, to later show that all decisions the attorney made were in the donor's best interests.

TRUSTS

George and Susan can also provide for continuing management of their property after incapacity by creating a trust and transferring some or all of their property into the trust. A trust can help them manage only their property; a trustee acting under a trust document can't make decisions about their personal care.

[10] Substitute Decisions Act. A guardian may be appointed under section 22 for property, and under section 55 for personal care, in both cases even when a substitute decision maker is already in place. Section 42 deals with passing accounts.

A trust is a relationship between the settlor (the one who transfers the property into trust), the trustee (the one who is to own the property) and the beneficiary (the one for whose benefit the trustee owns the property).

Trusts can serve many estate planning objectives beyond planning for incapacity:

- **Remove property from the settlor's estate**. If the settlor's will is probated, the lower the value of the property passing through the will, the lower the probate tax.
- **Allow for continuing control**. George and Susan could be trustees and beneficiaries of their trust, as long as someone other than themselves was also named as a beneficiary (for example, to receive the trust's property at George and Susan's deaths). A trusted individual could be an alternate trustee if George and Susan became incapable of managing the trust's assets.
- **Protect the settlor's privacy**. Assets transferred by trust to beneficiaries at the settlor's death are transferred privately. A probated will is a public document.
- **Allow for detailed instructions**. A trust can provide more extensive guidance to a trustee than a power of attorney, or can provide more detail on the limits of a trustee's powers than a power of attorney. However, it's important that the settlor (or donor, if a power of attorney is used) choose someone they can trust; no amount of instruction in a document can overcome the consequences of a poor choice of trustee or attorney.
- **Protect the settlor's intentions from challenge**. Probate affords a process for interested parties to challenge a will. No similar process exists for challenging a trust (though challenging a trust is still possible).
- **Creditor protection**. Trusts can provide a greater measure of creditor protection for assets than personal ownership.
- **Cost**. A trust is more expensive and complicated to create and administer than a power of attorney.
- **Taxation**. Income from assets owned in an inter vivos trust (a trust established during the settlor's lifetime) will be taxed at the highest marginal tax rate, and will not benefit from personal tax credits (such as the basic personal amount).
- **Deemed disposition every 21 years for capital gains tax purposes**. Generally, a trust is deemed to dispose of its capital property every 21 years. This rule does not affect alter ego, joint

partner or spouse trusts (discussed below). Nor is it likely that the deemed disposition rule will affect health insurance policies (also discussed below).

George and Susan must also have their trust written so that a health insurance policy is an asset the trustee is allowed to own. Provincial and territorial laws govern what is and is not an allowable investment. But a trust's language can override those laws to allow the trustee to own assets like insurance policies that may not otherwise qualify for trust ownership.

George and Susan could either have the trustee apply for CII and LTCI policies, or transfer existing policies into a trust. There should be no tax consequences for transferring existing health insurance policies into a trust. While the Income Tax Act[11] (ITA) contains rules that treat the transfer of ownership of a life insurance policy as a disposition,[12] with potential tax consequences, it contains no such rules covering health insurance policies. Further, many health insurance policies do not have cash values, so they should pass without tax consequences into a trust even if the transfer is treated as a disposition of the policy.

ALTER EGO, JOINT PARTNER AND SPOUSE TRUSTS

Alter ego, joint partner and spouse trusts are special trusts authorized under the ITA for individuals and married or common law spouses age 65 and older.[13] Alter ego and joint partner trusts are inter vivos trusts. Spouse trusts can be either inter vivos or testamentary trusts. An alter ego trust is a trust that an individual creates to manage assets and provide income for him or herself. Income tax rules specify that only the person who created the trust can benefit from it during their lifetime. A joint partner trust is the same as an alter ego trust except that it's created by a couple, married or living

[11] Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), referred to herein as the ITA.

[12] ITA subsection 148(7) deems a life insurance policy transferred in a non-arm's length transfer to have been disposed of for proceeds equal to the greatest of its adjusted cost basis (ACB), cash surrender value (CSV), or the fair market value (FMV) of whatever the recipient of the policy pays to the transferor for it. The amount by which that amount exceeds the policy's ACB must be included in the transferor's income in the year of the transfer.

[13] Subparagraph 104(4)(a)(iv) of the IITA. While inter vivos spouse trusts are subject to this age restriction, testamentary spouse trusts are not. Spouse trusts are also referred to as spousal trusts. This case study will use the term "spouse trust".

common law. Spouse trusts are created by one spouse or joint partner for the benefit of the other spouse.

George and Susan could consider transferring all or some of their assets into a joint partner trust. To the extent that some of their assets could have unrealized capital gains, the transfer would not generate any tax consequences. Tax would be deferred until the trust sold the asset or until George and Susan died.

George and Susan would have to be the only ones entitled to receive income from the trust during their lives, and would have to structure the trust so that the trust assets would benefit only them during their lives. When the last between them dies, the trust would distribute their assets to whomever they had named in the trust (usually their children) or manage those assets for their trust beneficiaries' benefit.

If George or Susan had a critical illness or needed LTC, the trustee (the other spouse, if either George or Susan were incapacitated, or the alternate trustee if both were incapacitated) could claim the insurance proceeds and use those proceeds to pay for the care needed to recover from the critical illness or receive appropriate LTC.

The Canada Revenue Agency (CRA) has said that if an alter ego, joint partner or spouse trust owned a life insurance policy on the spouse's life the trust would be tainted and unable to benefit from the tax advantages provided in the ITA.[14] The CRA's reasoning is that paying the premiums for a life insurance policy is the same as making trust income or capital available for the use of someone other than the spouse or settlor; the spouse or settlor could never benefit from this expenditure because

[14] CRA Document 2012-0435681C6, May 8, 2012. See also CRA Document 2006-0185551C6, September 11, 2006. It's possible that the rule may also apply to life insurance owned by an alter ego trust, though there is no CRA guidance on that issue. The CRA's guidance contained in its interpretation bulletins, responses to taxpayer inquiries and advance tax rulings is the CRA's interpretation of the law on a given subject and can help taxpayers plan their affairs in order to comply with the law. However, the CRA is not bound by what it says in its interpretation bulletins or by its responses to taxpayer inquiries. The CRA is bound by the Income Tax Act and Regulations, and by judicial decisions, all of which have the force of law. It is also bound by the Advance Tax Rulings (ATR) it issues, but only to the individual taxpayer who requested the ruling, and only as long as the circumstances outlined in the request for the ATR remain unchanged. The CRA is free to take a different position on a same or similar question or ruling request from a different taxpayer.

the death benefit would be paid only after the spouse or settlor had died. The same objection does not apply to health insurance policies owned by any of these trusts because the benefit is available during the spouse's or settlor's lifetime. It's not certain, though, how the CRA would treat a return of premium at death (ROPD) rider attached to a trust-owned CII or LTCI policy. It may decide that the ROPD rider taints the trust the same as a trust owned life insurance policy. The parties would need to obtain their own tax advice if they were considering the ROPD rider. One way to avoid this problem is to have the insurance policy owned by a separate trust that is not an alter ego, joint partner or spouse trust.

TAX AND LEGAL ISSUES

The ITA does not specifically discuss health insurance policies, and the CRA has provided little guidance on their taxation. What follows is a general discussion. Further details on the tax treatment of health insurance policies are available in the Canadian Health Insurance Tax Guide:[15]

- **Premiums paid by individuals or entities for their own or their family's coverage are not deductible**. The ITA defines insurance premiums as "personal or living expenses" if the proceeds of the policy or contract are paid to or for the benefit of the taxpayer or to a person connected with the taxpayer by blood relationship, marriage or common-law partnership, or adoption.[16] Personal or living expenses are not deductible.[17]

- **The CII and LTCI base benefits are paid tax-free**. If a CII or income style LTCI policy meets the definition of health insurance under provincial or territorial law, the CRA treats it as a sickness or accident insurance policy (SAIP). Most CII and income style LTCI policies sold in Canada meet the provincial and territorial definitions of health insurance. Reimbursement LTCI policies (policies that reimburse the policy owner for covered long-term care costs) may also meet the definition of a

[15] Available at www.sunlife.ca/advisor/HealthTaxGuide.

[16] ITA subsection 248(1). See paragraph (b) of the definition, "personal or living expenses".

[17] ITA paragraph 18(1)(h).

private health services plan (PHSP). PHSP benefits are paid tax-free. According to CRA guidance, the base benefits from a CII or LTCI policy (income or reimbursement) are paid tax-free.[18]

- **You may not count CII or income style LTCI premiums towards a claim for the medical expense tax credit (METC)**. According to CRA guidance, one of the requirements for counting insurance premiums towards a claim for the METC under ITA paragraph 118.2(2)(q) is that all or substantially all of the benefits paid under the policy relate to medical expenses that are eligible for the METC (the CRA defines "all or substantially all" to mean at least 90%).[19] Because a CII or income style LTCI policy pays a benefit with no restriction on how you may use it, the benefit does not relate to medical expenses, and the premiums do not count towards a claim for the METC.[20] Premiums paid for reimbursement style LTCI policies may qualify as medical expenses if all or substantially all of the benefits payable under the policy would be medical expenses under ITA subsection 118.2(2), and if the CRA has ruled favourably on the policy.[21] See our article, "The Medical Expense Tax Credit" for more details.

- **Medical expenses may be claimed even if paid from tax-free insurance benefits**. If the insured person has a covered critical illness or needs long-term care, and uses the CII or income style LTCI benefit to pay hospital, medical, and/or nursing home expenses, the policy owner may be able to count those expenses towards a claim for the METC. It will not matter that the source of the money used to pay those expenses was a tax-free insurance benefit. Note: any expenses for which the policy owner received benefits from a reimbursement style LTCI policy may not be used as part of a claim for the METC (except any unreimbursed part of the expense, such as deductibles, co-payments, and claims over the policy limits).

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[18] There are no sections in the ITA that tax CII benefits. The CRA has said that a CII policy should be viewed as a "sickness" policy, and that the disposition (i.e. payment of the base benefit) from a CII policy is not taxable: CRA Document 2003-0004265, June 18, 2003. See also CRA Document 2003-0054571E5, December 24, 2004. Regarding LTCI, see CRA Document 2003-0048461E5, March 5, 2004

[19] CRA Document 2015-0610751C6, November 24, 2015. See additional CRA commentary at www.cra-arc.gc.ca/whtsnw/tms/phsp-rpam-eng.html.

[20] CRA Documents 9711505, June 2, 1997 (CII) and 2003-0048461E5, March 5, 2004 (LTCI).

[21] CRA Document 2000-0018375, May 29, 2000.

- **Corporations and entities may not claim the METC, only individuals**. The ITA allows individuals to claim the METC. The definition of an individual excludes corporations.[22] Regarding trusts, ITA subsection 118.2(1) speaks of the individual's (and spouse's and eligible dependents') medical expenses and income, and notes that an individual may make a claim for the METC in respect of expenses that they or their legal representative have paid.

- **Trust taxation**. Inter vivos trusts (trusts created during the settlor's lifetime) and testamentary trusts (trusts created at the testator's death) are both taxed at the top tax rate. An exception exists for testamentary trusts that qualify as graduated rate estates (GRE), which are taxed at graduated rates for the first 36 months of their existence. There can be only one GRE per individual, and, as the CRA notes (www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/ federal-government-budgets/budget-2014-road-balance-creating-jobs-opportunities/graduated-rate-taxation-trusts- estates-related-rules.html), a trust must satisfy the following conditions to be a GRE:
    a. the estate must designate itself, in its T3 return of income for its first taxation year (or if the estate arose before 2016, for its first taxation year after 2015), as the individual's graduated rate estate;
    b. no other estate can have designated itself as the graduated rate estate of the individual; and
    c. the estate must include the individual's Social Insurance Number in its return of income for each taxation year of the estate that ends after 2015 during the 36-month period after the death of the individual.

Another exception exists for qualified disability trusts (QDT).

CONCLUSION

It may not be enough to buy CII or LTCI. A couple like George and Susan needs to consider what could happen if they needed to claim insurance benefits but, because of a critical illness or need for

[22] ITA subsections 118.2(1) and subsection 248(1), c.f. "individual".

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LTC, lacked the capacity to manage their policy or policy benefits. For those who haven't planned, guardianship is the default option. But it's expensive, time-consuming and uncertain.

Signing a continuing power of attorney for property and a power of attorney for personal care is a less expensive and more certain way of helping to ensure that a person's wishes regarding their property and care will be respected even if they lack the capacity to manage either part of their life. A trust can provide tax benefits for property, but a trustee cannot make decisions concerning personal care.

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