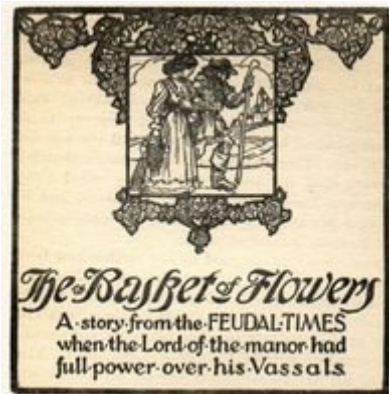


Creation and Alienation of Life Estates



By Brian Madigan LL.B.

Life estates are relatively straightforward; they are simply estates “for life”. So, if Robert leaves an estate to James for his lifetime, then when James dies, it is longer part of his property or estate.

It is the original donor, Robert who gets to decide once more who gets to enjoy this property. This gives Robert a lot of power and he could theoretically repeat this giving and taking for thousands of years. And, why not, after all it was his property?

Well, this might have been the case were it not for the basic concept of “taxes”, the other part of the “death and taxes” certainty. In this case, there are multiple deaths over thousands of years, but no taxes? Nobody is going to let that happen!

Taxation in feudal times was not that sophisticated. It was a simple inheritance tax. When real property was transferred to the next generation it was taxed. However, even in those days tax avoidance lawyers were hard at work. They came up with the concept of trusts and the transfer of the property several generations out. As long as actual “ownership” did not change, there would be no tax.

Naturally, this predicament didn’t set well with the King, and in **1681 the Statute of Uses** was passed. In addition, there was legislation which established the **rule against perpetuities**. In essence, the rule is as follows:

“no interest in real or personal property is good unless it must vest, if at all, no later than twenty-one years after a life in being”.

What the new rules were designed to do was render void any perpetual transfer. The rule made them void ab initio (meaning from the beginning). It was not necessary to wait several generations to find out; the gift simply failed, and the donor died intestate in respect to this property. That meant that it could be taxed by the King, and these rules were not an exercise in imaginative legislation, they were about money.

Although the rule itself seems simple enough, it becomes quite puzzling at times in terms of its application. The actual facts in any given case are ignored. What is important is the theoretical and philosophical analysis of whatever might be imagineable. In other words, is there any theoretical possibility that the vesting might take place beyond the 21 year limit? If so, the gift failed, the trust was not established, the proposed use was terminated, the donor died intestate in respect to this property, and most importantly, it was taxed (which indeed was the

purpose of this whole exercise in the first place).

As centuries passed, the rule against perpetuities produced some unfortunate results. So, there were some case law exceptions, and with each exception the law became more complicated. In fact, sufficiently so, that the failure on the part of a lawyer to understand the rule was not considered professional negligence.

Exceptions included the **Mortmain and Charitable Uses Act** which was designed to allow religious communities to flourish without taxation. Mortmain was the "dead hand", and the social policy concern was how much credence do we really give to someone who died hundreds of years ago. Seriously, why do they get to decide?

Modern taxation codes take a different approach, they simply state that the tax will apply in certain circumstances notwithstanding the legal mechanism used. So, the issue of taxation was one step removed from the law (that is the law of property or the law of trusts), and it was not longer necessary to follow the tax lawyers and their various schemes to avoid taxes, just simply say there's going to be a tax, and there's no way out no matter what you do.

With that approach, and the general lack of success from the tax avoidance perspective, the rule against perpetuities was relaxed somewhat.

Life interests can be bought and sold. If Robert leaves his property to John (for John's lifetime) and then to William; who is going to buy out John's interest? Probably William, who else? What is the price? You would obtain an actuarial valuation of John's interest. What is his expected lifetime? The future value of his interest in the estate at the time of his death will be zero. What is the value now? What is the value of the expected stream of income over John's lifetime? Then, William should offer that amount, acquire John's interest. Now, he owns both the life interest and the future (or capital interest) and so he can sell the property in its entirety and give good title. Otherwise, neither John nor William had interests that were marketable when you are talking about real property.

For other interests in the form of income streams, they are saleable to insurance companies who are likely the only purchasers for this type of property. Most of the time, they sell annuities, but they also buy them.

Here's the short version:

- 1) John can sell his interest
- 2) William can sell his interest
- 3) neither however can sell the property
- 4) John and William can sell the property together, or

5) James can buy each interest separately and then, put them together and own the "property"

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