

OBA Professional Development

Kissing Cousins: Where Family Law and Estates and Trust Law Meet

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DISCRETIONARY TRUST ESSENTIALS

A discretionary trust is one where the trustees are empowered to make distributions among the beneficiaries as they think fit. The trustees may not only select which beneficiaries will receive distributions, but also the quantum and timing of such distributions.

While the use of discretionary trusts is longstanding and their general principles are well established, the law pertaining to select aspects of discretionary trusts is still in development. This discussion explores: A. the valuation of interests in discretionary trusts and B. trustee obligations to disclose information to beneficiaries. These areas of the law are continuing to evolve as the courts struggle to find a balance between family law and trust law principles.

A. Valuing interests in discretionary trusts

It is difficult to value a discretionary interest in a trust since it is unknown whether the beneficiary will ever receive a distribution, or what the value of such distribution may be.

The valuation of a trust interest generally depends on the reason for which it is being valued. For example, valuations for the purpose of sale and assignment of the interest, for income tax purposes and for family law claims, may differ greatly.¹

¹ See “Family Trusts Under Canadian Family Law” Lorne H. Wolfson, Adam N. Black and Emily Hubling, Canadian Family Law Quarterly, 32 CFLQ 275, 2013 [“Wolfson”].

(a) In Trust Law

The traditional trust law principle was that a discretionary beneficiary who had not yet received a benefit from a trust could not be said to have an existing property interest in the trust, but rather only a right to be considered for a distribution by the trustees.²

For this reason, interests in discretionary trusts have typically been assigned nominal values for the purposes of estate planning, asset protection and tax minimization.

(b) In Tax Law

Canada Revenue Agency (“CRA”) has rejected the orthodox trust law approach of placing a nominal value on discretionary interests. It has stated that while it is difficult to quantify such a value, it would be:

“unreasonable to conclude that the [fair market value] of an interest [in] a discretionary trust holding property with significant value has no value simply because it is difficult to measure. In absence of any term of the trust that would direct the trustees to favour one beneficiary over another, the even handed principle would suggest that [the] value of each beneficiary’s interest was approximately equal. Where the facts support a finding that one beneficiary has a lesser chance of receiving a distribution from the trust than another beneficiary, it may be appropriate to discount the value of one interest and increase the value of another.”³

(c) In Family Law

A spouse’s interest in a discretionary trust has been held to be property of the spouse for the purposes of equalizing net family properties.⁴ Section 4(1) of the *Family Law Act* defines “property” very broadly to mean:

“any interest, present or future, vested or contingent, in real or personal property and includes

- (a) property over which a spouse has, alone or in conjunction with another person, a power of appointment exercisable in favour of himself or herself,
- (b) property disposed of by a spouse but over which the spouse has, alone or in conjunction with another person, a power to revoke the disposition or a power to consume or dispose of the property, and
- (c) in the case of a spouse’s rights under a pension plan, the imputed value, for family law purposes, of the spouse’s interest in the plan, as determined in accordance with section 10.1, for the period beginning with the date of the marriage and ending on the valuation date”.

² “Valuation Issues and Discretionary Trusts” Margaret O’Sullivan, *Estates, Trusts & Pension Journal*, vol 28, 2008 at 76 [“Margaret O’Sullivan”].

³ CRA Doc 2003-0181465: Fair market value of an interest in a discretionary trust [“CRA Doc 2003-0181465”]; see also “69(1)-(5) - Inadequate Considerations” McCarthy Tétrault Analysis, *Taxnet Pro*, August 31, 2015 (accessed online March 23, 2016).

⁴ Wolfson supra note 1 at 1.

Courts have generally applied a liberal interpretation of this definition to include interests in discretionary trusts.⁵ With respect to the valuation of such an interest, family courts have favoured the application of a “fair value” test in lieu of a “fair market value” test.⁶ The fair value of an asset will be determined by considering all circumstances surrounding the valuation, including the nature of the property,⁷ the life expectancy of the beneficiary, the number of beneficiaries, the value of the trust property and other contingencies. Family courts have adopted varied methodology to the fair value approach to date:

- In the Ontario case of *Sagl v Sagl*,⁸ the court adopted a “compromise approach” to arrive at a fair value of the discretionary interest in question for the purposes of calculating the net family property of the husband. In this case, the husband and children were discretionary beneficiaries of the trust. The court selected a value that produced the fairest and most equitable result for the spouses for the purposes of property division, having regard to trust law, the definition of property and the evidence as to what the intention was at the time of the creation of the trust. In this case, the value was calculated as though there were a deemed realization among all the beneficiaries at the valuation date. While CRA has stated that this approach is reasonable,⁹ it has been criticized for its lack of methodology. Gordon, J. recently commented in the Ontario case of *Dillon v Dillon*¹⁰ that:

“*Sagl* cannot be considered as establishing new legal principles on trust law. The methodology employed was used to resolve the issues but, in my view, was contrary to accepted principles. *Sagl* has not been followed in subsequent cases.”

- In the Alberta case of *Kachur v Kachur*,¹¹ the court held that a spouse who was named as a beneficiary of a trust, along with his children, had no interest in the trust as there was sufficient evidence to support the conclusion that the children held the entire trust interest. Such evidence was primarily based on the historic operations of the trust, including prior distributions (none of which had been made to the spouse) and the intentions of the settlor.¹²

⁵ See *Brinkos v Brinkos* (1989), 60 DLR (4th) 556, 69 OR (2d) 225 (ONCA); *DaCosta v DaCosta* (1992), DLR (4th) 268, 7 OR (3d) 321 (ONCA); and *Black v Black* (1988), 66 OR (2d) 643 (Ont HCJ); see also Wolfson supra note 1 at 5-6 and Margaret O’Sullivan supra note 2 at 78.

⁶ Wolfson supra note 1 at 10.

⁷ See L.H. Wolfson, “*Sagl v Sagl*: Valuation of an Interest in a Discretionary Trust under Ontario’s *Family Law Act*” (1998), 13 Money & Family Law at 20 and Wolfson supra note 1 at 10.

⁸ *Sagl v Sagl*, 1997 CarswellOnt 2144, [1997] OJ No 2837 (Ont Gen Div).

⁹ CRA Doc 2003-0181465 supra note 3, wherein CRA stated:

“The difficulty in establishing the value of an interest in a discretionary trust was acknowledged in the case of *Sagl v. Sagl*, (1997) 31 R.F.L. (4th) 405. In that case, it was held that a reasonable approach would be to value the interest as if the trust assets were fully distributed equally among all the contingent beneficiaries on the valuation date. In our view, this would be a reasonable approach to take in many cases involving the valuation of an interest in a discretionary trust. However, where the terms and conditions of the trust are such that this approach does not yield an appropriate result, it may be necessary to apply a discount factor in recognition of the uncertainty caused by any condition precedent or condition subsequent that could affect the value of the beneficiary’s interest in the trust. As with business equity valuations, the valuator must use reasonable judgment and objectivity in the selection and analysis of the relevant facts of each valuation.”

¹⁰ *Dillon v Dillon*, 2014 ONSC 2236 at para 289.

¹¹ *Kachur v Kachur*, 2000 ABQB 709.

¹² For a fuller discussion, see Wolfson supra note 1 at 14-15 and Margaret O’Sullivan supra note 2 at 86-88.

- In the 2014 Ontario case of *Mudronja v Mudronja*,¹³ the court valued a husband's interest in a discretionary trust where the husband acted as the sole trustee and the beneficiaries were his wife, his issue and a corporation. Because the husband was the sole trustee and the person with a full power of appointment, the entire trust property was included as the husband's property for the purposes of family property division. The trust deed specifically stated that the power of appointment was a personal power, not a fiduciary one, and included the power to declare himself a beneficiary.¹⁴ The wife's discretionary interest in the trust was nominally valued at \$1.00 since she had no right or power to either require or prevent the disposition, transfer or encumbrance of the entire trust value.¹⁵
- Similarly, in the 2015 Saskatchewan case of *Grosse v Grosse*,¹⁶ the husband was the sole trustee of a trust benefitting himself and his children. Because he was the sole trustee having complete control over the trust, he could not be said to be a "contingent" beneficiary for family property division purposes. Accordingly the whole interest was included as his property. In this case, the trial judge's "if and when" order was set aside and the Court of Appeal concluded that such orders "should be avoided, if possible, as they tie spouses together financially for an indefinite period of time and can lead to future conflict."¹⁷
- In the Ontario case of *LeVan v LeVan*,¹⁸ the court valued the husband's discretionary interest at 25% based on the terms of the trust established by his mother and evidence with regard to her intention to treat her four children equally.
- In the 2012 Ontario Court of Appeal case of *Spencer v Riesberry*,¹⁹ the value of the wife's contingent interest in a trust set up for her, her siblings and her mother, by her mother, was included in the wife's net family property. However, it was held that the wife did not have any specific legal interest in the real estate held within the trust and, accordingly, it was not subject to matrimonial home claims and her husband was not granted additional rights to the real estate itself.²⁰
- In the Ontario case of *Kushnir v Lowry*,²¹ the court accepted the wife's position that 50% of the discretionary trust's assets be included in her net family property on the basis that she was one of two beneficiaries and, therefore, she and the other beneficiary, being her daughter, were each entitled to a 50% interest in the trust.

13 *Mudronja v Mudronja*, 2014 ONSC 6217 ["*Mudronja*"].

14 *Ibid* at paras 90 and 93.

15 *Ibid* at paras 99 and 100.

16 *Grosse v Grosse*, 2015 SKCA 68 ["*Grosse*"].

17 *Ibid* at para 60.

18 *LeVan v LeVan*, (2006) 82 OR (3d) 1, aff'd 2008 ONCA 388; referenced in *Mudronja* supra note 13 at para 95.

19 *Spencer v Riesberry*, 2012 ONCA 418.

20 *Ibid*; Wolfson supra note 1 at 6.

21 *Kushnir v Lowry*, [2004] OJ No 375 (ONSC); referenced in *Mudronja* supra note 13 at para 94.

For the purposes of determining support under the *Federal Child Support Guidelines*²² and Ontario's *Child Support Guidelines*,²³ under s. 19(1)(i) of both guidelines, the court may impute income where the spouse is a beneficiary under a trust and may be in receipt of income or other benefits from the trust. Pursuant to s. 19(1)(d) of both guidelines, the court may also impute income where it appears that income has been diverted, such as through a trust, to the extent that it may affect the quantum of child support.

B. Trustee obligations to disclose information to beneficiaries

(a) In Trust Law

Trustees have a duty to account for the administration of a trust to those who have an interest in the trust.²⁴ Particularly, trustees have a duty to beneficiaries to provide accurate information and to make trust documents available for their inspection.²⁵ The scope of the duty to provide such information and trust documents, however, remains uncertain.²⁶

Historically, courts found that beneficiaries were entitled to inspect trust documents based on a “proprietary right” of the beneficiaries to the documents themselves.²⁷ This traditional approach has been criticized²⁸ and courts now generally support a balancing of interests approach, as outlined by the Privy Council in *Schmidt v Rosewood Trust Ltd.*²⁹ In determining disclosure obligations of a trustee, the principle of broad disclosure and the need to preserve the confidentiality of trustee deliberations must be balanced. The onus remains on the claimant beneficiary to demonstrate why disclosure is justified.³⁰ A variety of factors will be considered by the courts in determining whether to grant an order for disclosure, including:

Nature of the beneficiary's interest

Residual or contingent beneficiaries will have a weaker claim to disclosure of trust documents as they have a more remote expectation of benefit under the trust.³¹

Nature of documentation requested

Beneficiaries will often seek disclosure of (i) information about the existence of the trust (eg. a copy of the trust settlement or indenture), (ii) trust accounts and financial

²² *Federal Child Support Guidelines*, SOR/97-175 [“*Federal Child Support Guidelines*”].

²³ *Child Support Guidelines*, O Reg 391/97 [“*Child Support Guidelines*”].

²⁴ *Waters' Law of Trusts in Canada*, 4th ed, Toronto: Thomson Reuters Canada Limited, 2012 [“*Waters*”] at 1119.

²⁵ *Barkin v Royal Trust Co*, 2002 CarswellOnt 669, [2002] OJ No 661 (ONSC); *International Trust Laws*, Jordan Publishing, Chapter on Canada, John O'Sullivan, Pia Hundal, Lucinda E. Main and Andrea Tratnik, January 2015 [“*International Trust Laws*”] at para A38.263.

²⁶ “What Privilege Does a Trustee Enjoy” John O'Sullivan and Christine Wong-Chong, 13th Annual Estates & Trusts Summit, 18 November 2010, Law Society of Upper Canada, Association of Contentious Trust and Probate Specialists (ACTAPS) Newsletter July 2011 [“O'Sullivan”] at 4-1; see also “Disclosure of Trust Documents Revisited” David A. Steele, (1995-1996) 15 Est & Tr J 218 at 218 (Heinonline).

²⁷ *O'Rourke v Darbishire*, [1920] AC 581 HL (Eng); *ibid* at 4-3.

²⁸ See, for example, *Ballard Estate (Re)* (1994), 20 OR (3d) 350 (Gen Div) [“*Ballard*”].

²⁹ *Schmidt v Rosewood Trust Ltd.*, [2003] 1 AC 709 (Eng PC) [“*Schmidt*”]; *International Trust Laws* supra note 25 at para A38.261.

³⁰ *International Trust Laws* supra note 25 at para A38.266; O'Sullivan supra note 26 at 4-35.

³¹ O'Sullivan supra note 26 at 4-36.

statements, and (iii) evidence relating to the dispositive and administrative discretions of the trustees, including trustee minutes and letters of wishes.³²

Trustees are generally required to disclose documents relating to the first two categories.³³ With respect to the third category, trustees are not obligated to disclose reasons for their exercise of a discretionary power where no misconduct is alleged.³⁴ In *Londonderry's Settlement*,³⁵ the court exempted from disclosure those documents relating to discretionary decisions. It was held that, to ensure due administration of a trust, trustees require this right not to disclose, otherwise it would be too difficult for trustees to make sensitive decisions. This right effectively reduces the scope for litigation and insulates trustees' decisions from beneficiary interference.³⁶

A trust instrument may restrict the trustee's usual duties to account and disclose but cannot fully eliminate them. Disclosure cannot be restricted in such a way that beneficiaries are prevented from holding trustees accountable under the trust.³⁷

Reason for the beneficiary's request

Where an improper exercise of discretion, a breach of trust claim or other misconduct is alleged against a trustee, courts may compel disclosure of documents evidencing discretionary decision-making.³⁸

Adverse consequences of disclosure

The interests of various involved parties, including the trustees, settlor and third parties, must be considered and balanced. To minimize the risk of any adverse consequences, trustees may consider arranging for professional inspection, producing the documents in a redacted form or providing confidentiality undertakings that restrict the use of the documents and the reach of exposure to third parties.³⁹

Other practical considerations

Trustees should consider maintaining minutes of their decisions in case they should be called upon to provide complete disclosure by a court. While trustees exercising a discretionary power are not bound to disclose their reasoning, their soundness could be considered by the court.⁴⁰

³² *Waters* supra note 24 at 1125.

³³ "Trustees' Duties of Disclosure to Beneficiaries" Melanie Yach and Elizabeth Bozek at 2.

³⁴ "Production of Estate Documents in Contested Beneficiary Litigation" Justin de Vries and Gillian Fournie ["de Vries"] at 5.

³⁵ *Londonderry's Settlement, Re*, [1965] 1 Ch 918 (Eng CA).

³⁶ *International Trust Laws* supra note 25 at para A38.264; see also de Vries at 7-9.

³⁷ David A. Steele, "The Beneficiary's Right to Know" (Paper delivered at the Fourth Annual Estates and Trusts Forum, Toronto, Law Society of Upper Canada, November 20, 2001) at tab 5-28; *International Trust Laws* supra note 25 at para A38.265; for a fuller discussion, see O'Sullivan supra note 26 at 4-16 to 4-18.

³⁸ *Ballard* supra note 28.

³⁹ O'Sullivan supra note 26 at 4-38.

⁴⁰ *Ibid*.

(b) In Litigation

A litigant's right to productions is of course distinct from a beneficiary's right to disclosure under trust law. Accordingly, once trust litigation is commenced, the balancing approach discussed above cannot override production obligations set out in Ontario's *Rules of Civil Procedure*.⁴¹ These obligations provide litigants with a broader scope of disclosure over trust-related documents than an ordinary beneficiary.⁴²

While claims for disclosure may be opposed on the grounds of legal privilege, these may be resolved by reference to the common or joint interest rule, which provides that a trustee cannot claim privilege over communications in whose subject matter the beneficiary has a joint interest such as those concerning the administration of the trust.⁴³ However, solicitor/client privilege remains intact with regard to legal communications with a trustee that pertain to her protection from claims against her by beneficiaries.⁴⁴

(c) In Family Law

In the family law context, additional disclosure obligations can be found in the *Federal Child Support Guidelines*,⁴⁵ *Child Support Guidelines*⁴⁶ and Ontario's *Family Law Rules*.⁴⁷ For the purposes of child support under s. 21(1)(g) of both guidelines, for example, a copy of the trust settlement and three most recent financial statements must be provided where the spouse is a beneficiary of a trust. These documents must also be served in accordance with Rule 13(3.3)9. of the *Family Law Rules* if the spouse was a beneficiary under a trust on the valuation date and if the spouse is required to file a financial statement under the *Family Law Rules*. Where a beneficiary spouse does not have access to trust-related documents, the trustees may need to be served with the motion for disclosure.⁴⁸

41 Ibid at 4-31; see also *Schmidt* supra note 29.

42 *Patrick v Telus Communications Inc*, 2005 BCSC 1762, 2005 CarswellBC 3086 at para 31; see also de Vries supra note 34 at 10.

43 O'Sullivan supra note 26 at 4-34.

44 *Chang v Lai Estate*, 2014 BCSC 128 at para 20; *Prubant v Society for Pastoral Counselling Research*, 2014 ONSC 347 at para 15; *Haydu v Nagy*, 2012 BCSC 1870 at para 25; *Cooke v Canada Trust Co*, 2005 BCCA 112 at para 14; *Pothos Leasing Ltd v Headon*, 2003 CarswellOnt 4928, [2003] OJ No 5067 (ONSC) at para 23.

45 Federal Child Support Guidelines supra note 22.

46 Child Support Guidelines supra note 23.

47 *Family Law Rules*, O Reg 114/99.

48 *Leinburd v Leinburd*, 2003 CarswellMan 510 (QB); Wolfson at 21.