

Financial Literacy for Family Lawyers

Trusts in Family Law

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Overview:

Trusts are a flexible tool used in all aspects of our economy. They were developed as a means of protecting and perpetuating the wealth of high income families. It is perhaps not surprising that they make an appearance in family law cases. A trust is a relationship between trustee and beneficiary. Trust law has well developed principles about this relationship. How trusts fit into family property and support law in Ontario and similar jurisdictions is not as well-developed, with basic concepts still subject to uncertainty such as: whether a trust interest is property, how it should be valued if it is property, and when to impute trust benefits into income for support purposes.

1. Is a trust interest property?

The definition of property for purposes of equalization under the *Family Law Act* is: “plain, direct and broad..”¹ S. 4(1) of the Act provides:

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

¹ *Brinkos v. Brinkos* 1989 CarswellOnt 252 (Ont.C.A.) at para. 8

- (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 marriage and ending on the valuation date;²

This broad definition of property at first glance appears to cover comfortably both the interests of trustees and of beneficiaries. In an early case under the Act, *Brinkos v. Brinkos*, the Court of Appeal held that a spouse's beneficial life interest in the income from a trust is property within the statutory definition. In deciding this, the Court of Appeal drew a number of conclusions on issues still relevant to the jurisprudence today:

1. A life interest under a will is property under the Act;³
2. The words "vested" and "contingent" in the definition of property should be interpreted as in estates or real property law. That is: "a future estate or interest is vested when there is a person who has an immediate right to that interest upon the cessation of the present or previous interest. A future interest is contingent if the person to whom it is limited remains uncertain until the cessation of the previous interest."⁴

² *Family Law Act* R.S.O. 1990, c.F.3, s. 4(1)

³ *Brinkos* at para. 10

⁴ *Re Legh's Resettlement Trusts: Pub. Trustee v. Legh*, [1938] Ch.39 at 52, [1937] 3 All E.R. 823 (C.A.) cited in *Brinkos* at para. 14

3. Whether an item is alienable or inalienable, it is still property.⁵

Following *Brinkos* a consensus appeared to have developed in Ontario jurisprudence that a beneficial interest in a trust is property under the Act. Decisions turned not on that issue but on how to value such an interest if discretionary in nature. There were a number of cases in which courts implicitly considered a beneficial interest in a discretionary trust as property under the Act without any analysis of the question as to whether it was within the statutory definition.⁶ This changed in *Durakovic v. Durakovic*⁷ where the court found that a beneficial interest in a discretionary trust does not fall within the definition of property under the Act unless the spouse has control over the trust or the trustee is required to provide funds in certain exigent circumstances to the spouse. In reaching this conclusion, the trial judge relied on the jurisprudence on what are now called Henson Trusts. Under Ontario's benefits legislation, a recipient of a disability pension may not have liquid assets over a certain threshold. In *Ontario (Director of Income Maintenance, Ministry of Community and Social Services) v. Henson*, the Court of Appeal affirmed that the interest a disability claimant has as the object of a discretionary trust does not fall within the definition of liquid assets in the *Family Benefits*

⁵ *Brinkos*, at para. 16-18

⁶ *Mudronja v. Mudronja* 2014 CarswellOnt 15112 (Ont.S.C) at para. 94-95

⁷ *Durakovic v. Durakovic* 2008 CarswellOnt 5329 (Ont.S.C.) at para. 162

Act.⁸ Unlike the definition of property in the *Family Law Act*, the definition of “liquid assets” in the *Family Benefits Act* is specific and narrow.

R.1(1)(a) “Liquid assets” means cash, bonds, stocks, debentures, an interest in real property, a beneficial interest in assets held in trust and available to be used for maintenance, and any other assets that can be readily converted to cash.⁹

The trial judge in *Durakovic* acknowledged the difference in definition between the *Family Law Act* and the regulations to the *Family Benefits Act* but did not discuss the implications, if any, of that difference on the question of whether the object of a discretionary trust must include that interest in his or her net family property.

Some years later, in *Mudronja*, the court considered the argument that from a trust law perspective the object of trustee discretion does not have an existing property interest but, rather, an expectancy.¹⁰ The court concluded, however, that the definition of property in the *Family Law Act* must be read contextually in light of the purposes of the Act. The preamble to the Act provides for: “the orderly and equitable settlement of the affairs of the spouses upon the breakdown of the partnership.” The court held that to ensure an equitable result on marriage breakdown a trust interest cannot be

⁸ *Ontario (Director of Income Maintenance, Ministry of Community and Social Services) v. Henson* 1987 CarswellOnt 654 (Ont.Div.Ct.), aff’d, 1989 CarswellOnt 542 (Ont.C.A.)

⁹ *Reg. 318, R.R.O. 1980, as am.*

¹⁰ *Mudronja* at para. 96 citing Margaret O’Sullivan, “Valuation Issues and Discretionary Trusts” [2008], *Estates, Trusts and Pensions Journal*, vol. 28 at pp. 75-56

automatically excluded from a spouse's property because it is discretionary and concluded: "The approach needs to be contextual, having regard to the particular circumstances of the parties, their financial situation and the terms of the trust in relationship to the marital relationship on V-day."¹¹ In the particular circumstances of *Mudronja*, the court had no difficulty in finding that the husband's beneficial interest was property as he was the sole trustee of the trust, the trust deed granted him the power, not as a fiduciary, to name himself as beneficiary of the trust, and he had the discretion to distribute the trust assets to himself and to dispose of them in any manner he deems suitable.¹²

In three more recent decisions, courts have approached this problem without specific reference to the *Mudronja* analysis. In *Kochar v. Kochar*, the court concluded, *in obiter*, that a beneficiary to a discretionary trust has no more than an expectancy, absent a power of appointment. In *Tremblay v. Tremblay*, the court did not refer to *Mudronja* but followed the same approach concluding that while traditional trust principles characterize a discretionary trust interest as an expectancy, in family law different principles apply. Rather than looking to the language of the *Family Law Act*, the court cites "the principles

¹¹ *Mudronja* at para. 98

¹² *Mudronja* at para. 82-83 and 89-90

of equity underpinning the fair sharing of wealth accumulated during a marriage.”¹³ In *Tremblay*, the court acknowledges that a trust is “fundamentally a relationship characterized by separation.”¹⁴ Where the beneficiary has control over the distributions of the trust, that separation is undermined. In those cases, the interest falls within the definition of property under the *Family Law Act*.¹⁵ *Tremblay* identifies a series of non-exhaustive factors to consider when determining whether the beneficiary directly or indirectly controls the trustees, such as:

- a. Any evidence with respect to the founding intent of the trust. Was the trust designed to effectively allow control by the beneficiary?
- b. The composition of the trustees, including whether the beneficiary is a trustee;
- c. Any requirement, including veto powers, that the beneficiary be part of any trustee decisions;
- d. Any history of past trustee actions which demonstrate direct or indirect control by the beneficiary;
- e. Any powers of the beneficiary to remove trustees, or to appoint replacement or additional trustees;

¹³ *Tremblay v. Tremblay* 2016 CarswellOnt 922 (Ont. S.C.) at para. 29

¹⁴ *Tremblay* at para. 29

¹⁵ *Tremblay* at para. 31

- f. The relationship of the beneficiary to the trustees. Are the trustees independent and at arm's length or are they instead family members or other persons who may not act independently.¹⁶

In *Borges v. Santos*, a support enforcement case, the court, in *obiter*, cited *Durakovic* and *Kochar* and found that absent control or a requirement of the trustee to provide funds in exigent circumstances, an interest as beneficiary of a discretionary trust falls outside the definition of property in the *Family Law Act*.¹⁷

In *Creighan v. MacPhee*, the Prince Edward Island Court of Appeal addressed the question of whether discretionary trusts are property, working with very similar legislation to Ontario's *Family Law Act*. The Court of Appeal did not opine on the ultimate issue as the case concerned a third party disclosure application directed at trustees; the Court did, however, provide guidance relevant also the interpretation of Ontario's legislation:

¹⁶ *Tremblay* at para. 32

¹⁷ *Borges v. Santos* 2017 CarswellOnt 15176 (Ont.C.J.) at para. 39-31

- a. The definition of property is broadly drafted and inclusive¹⁸;
- b. A power of appointment is not a necessary element for a trust interest to be property;
- c. A beneficial interest in a discretionary trust has been recognized as a form of property, that is as a chose in action, capable of protection by a court in equity.¹⁹
- d. The question of a spouse's interest in the trust is considered in the context of the evidence of actual control and acts of ownership.²⁰

The degree of control that a spouse has over a discretionary trust interest has always been relevant to the value of the interest. A number of courts have now imported the question of control into the primary issue of whether the asset is property or not under the *Family Law Act*. Whether that is a sustainable reading of the “plain, direct and broad” language of the Act that our appellate courts will uphold remains to be seen. From a practitioner's perspective the question of whether a discretionary trust interest is property is more open than it has been since the Act was introduced. Given the potential to shield

¹⁸ The definition matches the Ontario language on the significant points.

¹⁹ *Creighan v. MacPhee*, the *Creighan v. MacPhee* 2017 CarswellPEI 80, aff'd 2018 Carswell PEI 1 (P.E.I.C.A.) at para. 18, citing *Gartside v. Inland Revenue Commissioners* (1967), [1968] 1 All E.R. 121 (U.K. H.L.) at 134. In the English case, the interest was found to be property but not a taxable interest under the tax legislation.

²⁰ *Creighan v. MacPhee* at para. 28

significant assets from equalization using this vehicle if a beneficial interest in a discretionary trust is not property or only property if the beneficiary has control, there will be further litigation on this point until there is clear direction at the appeal level.

2. When is a trust a sham?

A trust must have certainty of intention by the settlor, certainty of the subject matter of the trust and certainty of the object of the trust. Where a settlor does not truly intend to create a trust and dispose of assets, but rather wishes to maintain real control over the assets but use the form of the trust to frustrate creditors, spouses, or the tax authorities, that is a sham trust. It fails the requirement of certainty of intention to create the trust.²¹ If a court finds a trust purportedly settled by a spouse is a sham then the assets of the trust fall within that spouse's net family property. The onus of proving that the trust is a sham will lie on the spouse challenging the trust. It will be a hard task to prove that a trust settled well before separation is a sham. Courts are reluctant to find a sham where a trust has operated for some years given the potential tax consequences as well as the interests of the beneficiaries of the trust.²²

²¹ *C.(J.A.) v. C.(V.R.)* CarswellYukon 27 (YKSC) at para. 110-112

²² *C.(J.A.) v. C.(V.R.)* at para. 124 and see *Hockey-Sweeney v. Sweeney* 2004 CarswellOnt 4422 (Ont.C.A.), leave to appeal to SCC denied, 2005 CarswellOnt 1431

3. Trusts and the matrimonial home

A beneficial interest in a trust does not give the beneficiary any property rights to a specific asset of the trust.²³ This principle permits spouses to circumvent the matrimonial home provisions of the *Family Law Act*. If a family home is owned by a trust of which one of the spouses is a beneficiary, it does not fall within the definition of matrimonial home in the Act. There is no loss of deduction for the value of the home at date of marriage, even assuming that the beneficial interest is property under the Act. There is no restriction on disposition and there are no rights of possession. This so even if the spouse is both beneficiary and trustee.²⁴

4. Valuation problems

Trusts present particular valuation problems. There may be discounts related to liquidity or contingencies for the beneficiary to receive the benefit of the trust. For discretionary trusts, the question of value turns on control. For example, in *Mudronja*, given the husband's power of appointment over the trust, the court allocated all the value of the trust's corpus, which were shares in a company, to his net family property. Although his wife was a beneficiary of the trust, the court allocated to her a value of \$1 for her interest as on the valuation date she and her husband were adverse and she could expect to

²³ *Spencer v. Riesberry* 2012 CarswellOnt 7589 (Ont.C.A.) at para. 37

²⁴ *Spencer v. Riesberry* at para.44

receive nothing from the trust.²⁵ By contrast, in *Sagl v. Sagl*, the court allocated to the husband a pro rata share of the value of the trust based on the number of beneficiaries at the valuation date, although he was a trustee with a power of appointment to appoint or remove a trustee.²⁶ An interesting Saskatchewan case, *Grosse v. Grosse*, considered these issues, albeit under a quite different family property regime. In *Grosse*, the Saskatchewan Court of Appeal shared the full value of the trust as family property. In that case, the husband as trustee and beneficiary had control over the trust with the discretion to take the entire income and capital of the trust. The court did not attribute any share in the trust to the parties' sons who were contingent beneficiaries.²⁷

5. Trust income and support

Trust income is also relevant for support determinations. A court may impute income to a spouse who receives income distributions or other benefits from a trust.²⁸ This is not limited to trust distributions. A spouse who receives a family loan that is likely to be repaid

²⁵ Mudronja at para. 99-101

²⁶ *Sagl v. Sagl* 1997 CarswellOnt 2144 (Ont.S.C.) at para. 32-37

²⁷ *Grosse v. Grosse* 2015 CarswellSask 339 (Sask.C.A.) at para. 44

²⁸ S.19(1) The court may impute such amount of income to a spouse as it considers appropriate in the circumstances, which circumstances include the following...

(i) the spouse is a beneficiary under a trust and is or will be in receipt of income or other benefits from the trust.

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if and when that spouse receives future trust distributions, may have that loan imputed into his income.²⁹ Capital disbursements from a trust to a spouse may also be imputed as income in an appropriate case, where the spouse is using the capital to support his lifestyle.³⁰ Where the recipient of capital disbursements from the trust for capital uses and the disbursements were not recurrent then they may not be included in income for support purposes.³¹ These cases are fact specific.

6. Documentary disclosure

To evaluate whether a trust interest is property, its value, and the impact on support claims may require significant disclosure. As a starting point, whether the spouse is trustee or beneficiary (or both), production of the trust deed, financial statements or balance sheets for the trust, trust tax returns, and the history of distributions, if any, are required. If the trust holds corporate interests, financial statements for those underlying assets may need to be obtained. Where the spouse is a beneficiary only, obtaining disclosure requires the involvement of third parties and complying with the procedural requirements for third party disclosure.³² Interestingly, in *Di Luca v. Di Luca*, the court ordered the spouse with the beneficial interest to shoulder

²⁹ *Newell v. Newell* 2012 CarswellOnt 7840 (Ont.S.C.) at 39

³⁰ *Jackson v. Jackson* 1997 CarswellOnt 4717 (Ont.Gen.Div.) at para. 27

³¹ *Clapp v. Clapp* 2014 CarswellOnt 10739 (Ont.S.C.) at para. 31

³² *Betel v. Betel* 2008 CarswellOnt 1491 (Ont.S.C.)

the burden of initiating a third party disclosure motion against the trust, rather than imposing that cost on the other spouse.³³ The breadth of disclosure ordered on disclosure motions relates directly to the extent to which the court accepts the validity of claims that the trust interest is property or relevant for support. If the court is not persuaded of the legitimacy of the claim, the third party disclosure requests will look like a fishing expedition.³⁴

In conclusion,

When trust issues arise in family law cases, whether property or support, they require careful analysis of the trust documents, the background circumstances of the settlement, the history of the trust, and the developing case law. With trust interests the chances are high that the spouses do not themselves understand them and that they have received advice about the nature of their interest from other professionals based on purely trust or estate principles that do not take into account the family law context. This is an area of law that would benefit from more guidance from the courts and to achieve that the cases that are litigated will need to be well presented by counsel alert to the particular factual and legal issues trust interests involve.

³³ *Di Luca v. Di Luca* 2004 CarswellOnt 767 (Ont.S.C.)

³⁴ As examples of this see *Kochar* and *Creighan*