Family Trusts in Family Law Cases: Issues and Concerns

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Overview

A trust is a relationship between the trustee and beneficiary. Trusts are simple in conception and highly flexible in application. Family trusts are used to manage and to some extent control the transfer of wealth between generations, to protect wealth the family has accumulated and to allow for flexibility in how that wealth is distributed amongst family members. Trusts are typically, although not universally, used by high net worth families. Family law issues frequently arise with respect to family law trusts because marriage and cohabitation agreements are more common in high net worth families where there is something to protect. Family trusts may complicate separations given the ongoing uncertainty of their treatment in family property law. Further, their presence pulls third parties into the resolution of issues arising from relationship breakdown.

Purpose and Proper Uses of Trusts – a family law perspective

Trust interests, whether as trustee or beneficiary, may come under intense scrutiny during a family law process. Trusts are governed by basic principles. 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. Once assets are settled on a trust, the settlor cannot recover them. A trust cannot be a stratagem to defeat creditors, the tax authorities, or

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spouses. A trust is a sham if the settlor did not truly intend to create a trust but rather wished to remain the true owner of the assets settled on the trust. Whether a trust has been properly constituted may become an issue at separation. Where assets have been settled on a trust by a spouse during the marriage, the other spouse may contest the legitimacy of the transaction. A party in a family law proceeding who challenges a trust as a sham bears the onus of proof. Courts are reluctant to find a sham given the potential tax consequences and the impact on the beneficiaries, so these claims can be an uphill battle, however.[2]

Trusts should not be a vehicle to circumvent family law rights and responsibilities. Provisions in a trust that purport to exclude the assets of the trust or income or benefits distributed to a beneficiary of the trust from the consequences under family law property or support regimes are no more than an attempt to impose a unilateral marriage contract and will generally not be effective. Pursuant to Part IV of the *Family Law Act* two spouses may choose to enter into a domestic contract with respect to their respective property and support obligations.[3] A trust deed cannot unilaterally impose a departure from these legislated rights and responsibilities. Having said that, anecdotally I have started to see trust deeds that try to do exactly that, which I expect will lead to litigation.

In one notable respect, however, a trust may be employed to avoid the protections accorded under the *Family Law Act* and that is with respect to matrimonial homes.[4] If a

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[2] *Hockey -Sweeney v. Sweeney* 2004 CarswellOnt 4422 (Ont.C.A.) leave to appeal to SCC denied, 2005 CarswellOnt 1431

[3] *Family Law Act*, R.S.O. 1990, c. F.3, as am

[4] *Family Law Act,* Part II

family home is owned by a trust that property does not fall within the definition of matrimonial home under the *Family Law Act*, even if one of the spouses is a beneficiary to the trust. There is no restriction on disposition and there are no rights of possession. If the value of the beneficial interest in the trust is included in a spouse's net family property as of the date of marriage and the date of separation, and the trust held the family home at both dates there is no loss of the date of marriage deduction, because the home was not owned directly by the beneficiary.[5]

Trusts in Family Property Cases

Almost 4 decades after the enactment of the *Family Law Act* with its equalization regime, the questions of whether all trust interests fall into the definition of property and how they should be valued have still not been conclusively determined. Spouses may have interests as trustees and/or beneficiaries in trusts. They may have powers of appointment or be subject to them. Under the *Family Law Act* the definition of "property" is very broad. S. 4(1) of the Act provides:

> "Property" means any interest, present or future, vested or contingent, in real or personal property and includes,
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> 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;
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> 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
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> 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

[5] *Spencer v. Riesberry* 2012 CarswellOnt 7589 (Ont.C.A) at para. 37 and 44.

The Ontario Court of Appeal has held that a spouse's beneficial life interest in the income from a trust is property in *Brinkos v. Brinkos*. In particular, the Court of Appeal held that:

1. A life interest under a will is property under the *Family Law Act*;[6]

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."[7]

3. Whether an item is alienable or inalienable, it is still property.[8]

Brinkos v. Brinkos did not, however, deal with a discretionary or sprinkling trust. There have been a number of trial level cases in which the court accepted that a beneficial interest in a property was property under Part I of the Act without much in the way of analysis.[9] In *Durakovic v. Durakovic*, the trial court did consider the foundational question of whether a discretionary interest in a beneficial trust falls within the definition of property under the Act and concluded that it does not, unless the spouse has control over the trust or the trustee is required to provide funds to the beneficiary.[10] The court relied on the jurisprudence on "Henson Trusts." These are trusts that are designed for the support of individuals in receipt of disability benefits. There are limits on the quantum of "liquid assets" that an individual may hold and still be eligible for a disability pension. "Liquid assets" is a defined term

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[6] *Brinkos v. Brinkos*1989 CarswellOnt 252 (Ont.C.A.) at para. 10

[7] *Re Leigh's Resettlemetn Trusts: Pub.Trustee v. Leigh,* [1938] Ch.39 at 52, [1937] 3 All E.R. 823 (C.A.) cited in *Brinkos v. Brinkos* at para. 13

[8] *Brinkos v. Brinkos* at para. 16-18

[9] *Mudronja v. Mudronja* 2014 Carswell Ont 15112 (Ont.S.C.) at para. 94-95

[10] *Durakovic v. Durakovic* 2008 CarswellOnt 5329 (Ont.S.C.) at para. 162

under the *Family Benefits Act* and the definition expressly includes assets held through a trust of which the disability pension claimant is beneficiary.[11] The Court of Appeal has held that if the trust is discretionary, then that contingency takes it out of the statutory definition of "liquid assets." This analysis is specific to the context of disability benefits which are distinct from the language and policy considerations of the *Family Law Act*.

The Supreme Court of Canada considered the same question in *S.A. v. Metro Vancouver Housing Corp.*[12] That case concerned whether an interest in a discretionary trust constituted an asset potentially disentitling the beneficiary from eligibility for assisted housing. The individual in this case was both co-trustee of the trust with her sister and beneficiary of the trust. Côté J., writing for the majority held that such an interest does not fall into the definition of "asset" because it is a "mere hope." The fact that the beneficiary cannot compel the trustees to make a distribution of the trust and cannot collapse the trust, as there is a gift over, takes the interest out of the category of "asset." While the applicant for assisted housing has an interest in the trust, unless and until she receives a distribution it does not fall within the definition of asset.[13] Justice Côté held that the applicant's role as trustee does not alter this analysis as she is only co-trustee, so any exercise of the

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[11] 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 maintenances, and any other assets that can be readily converted to cash. Reg. 318, R.R.O. 1980, as am.
[12] *S.A. v. Metro Vancouver Housing Corp* 2019 SCC 4
[13] *S.A. v. Metro Vancouver Housing Corp* at para. 49

discretion must be in concert with her sister and as a fiduciary. She does not have sole nor untrammeled control of the trust.[14]

The Supreme Court of Canada's in *S.A. v. Metro Vancouver Housing Corp*, like the Henson Trust decision, does not consider the nature of discretionary trusts in the context of the language or policy of the *Family Law Act*. The "mere hope" analysis, however, is consistent with how discretionary trusts have been understood in the estates and trust bars, if not in the family law bar. [15]Four Ontario trial decisions have explored the proper treatment of discretionary trust interests in equalization under the *Family Law Act*: *Mudronja v. Mudronja[16], Kochar v. Kochar,[17] Tremblay v. Tremblay[18]* and *Borges v. Santos[19].*

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. 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 automatically excluded from a spouse's property because it is

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[14] *S.A. v. Metro Vancouver Housing Corp* at para. 37.
[15] Margaret O'Sullivan, "Valuation Issues and Discretionary Trusts" [2008] *Estates, Trusts and Pensions Journal*, vol. 28 at pp. 75-76
[16] *Mudronja supra*
[17] *Kochar v. Kochar*2015 ONSC 6650 at para. 20,
[18] *Tremblay v. Tremblay* 2016 CarswellOnt 922 at para. 31
[19] *Borges v. Santos* 2017 CarswellOnt 15176 at para. 30-31

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.” 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.

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.[20]

In *Tremblay v. Tremblay*, the court concluded 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 of equity underpinning the fair sharing of wealth accumulated during a marriage.”[21] In *Tremblay*, the court acknowledges that a trust is “fundamentally a relationship characterized by separation.”[22] 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

[20] *Kochar,* at para. 20
[21] *Tremblay* at para. 29
[22] *Tremblay* at para. 29

the *Family Law Act*.[23] *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?
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> b. The composition of the trustees, including whether the beneficiary is a trustee;
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> c. Any requirement, including veto powers, that the beneficiary be part of any trustee decisions;
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> d. Any history of past trustee actions which demonstrate direct or indirect control by the beneficiary;
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> e. Any powers of the beneficiary to remove trustees, or to appoint replacement or additional trustees;
>
> 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.[24]

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.[25]

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

[23] *Tremblay* at para. 31
[24] *Tremblay* at para. 32
[25] *Borges v. Santos* at para. 30-31

at trustees; the Court did, however, provide guidance relevant also the interpretation of Ontario's legislation:

a. The definition of property is broadly drafted and inclusive[26];

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.[27]

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.[28]

So where does this leave the practitioner? We do not have appellate jurisprudence on this question in the context of family law, although we do now have the Supreme Court of Canada's formulation of a discretionary beneficiary interest as a "mere hope." That may carry the day when and if the question is litigated through the appellate courts. On the other hand, looking at recent lower court decisions that have been decided in the family law context, the degree of control may be decisive.

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[26] The definition matches the Ontario statutory language on the significant points.

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

[28] *Creighan v. MacPhee* at para. 28

If and when trust interests are accepted as property, their valuation raises its own challenges. A trustee's interest in a valid trust, should be worth nil. Following *Brinkos*, a fixed beneficial interest, however, where the distribution may be compelled by the beneficiary, is property. Its valuation may require expert evidence to address the relevant contingencies including liquidity. If a beneficiary of a discretionary trust is found to have a property interest, there is still no clear direction from the courts as to how that interest should be valued. In *Mudronja*, the court allocated all the value of the corpus of the trust to the husband, who held a power of appointment over the trust. Although the wife was a beneficiary of the trust, the court allocated only $1 to her interest.[29] 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 to appoint or remove a trustee.[30]

Trusts in Support Cases

Trusts are also relevant for support purposes. The Federal and Provincial *Child Support Guidelines* expressly approve the imputation of income for support purposes to a party who receives income or benefits from a trust.[31] These principles are applied to the determination of income for both child and spousal support. The history of distributions of the trust are relevant to whether income will be imputed to a spouse. S. 19(1)(i) also

[29] *Mudronja* at para. 99-101
[30] *Sagl v. Sagl* 1997 CarswellOnt 2144 at para. 32-37
[31] *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. *Federal Child Support Guidelines* SOR/97-175

expressly contemplates imputation of income where a spouse "will be in receipt of income or benefits from the trust." Examples of imputed income include:

a. A loan from the trust[32];
b. Capital disbursements from the trust where these have been used to support lifestyle, unless the receipts were not recurrent.[33]

In *F.B.M. v. B.F.*, the court would not impute income from a trust in the face of the testimony from the grandfather of the beneficiary, who was one of the trustees of the trust, that the trust would not make any future disbursements to the husband. This was despite a pattern of disbursements in the past. There was, however, an imputation of income based on a history of gifts.[34] These cases are fact specific.

Trust Disclosure Issues

Where a spouse has a trust interest, disclosure obligations will arise. These obligations are likely to extend beyond the spouse to the trustees of the trust. In family trusts there may be strong resistance to making full financial disclosure out of a desire for privacy. Unfortunately, where a spouse has an interest in a trust the disclosure obligations will take priority to any privacy interest. The first difficulty may be that families have not disclosed to all beneficiaries the existence of the trust. As an example, in *F.B.M. v. B.F.*, the husband was the beneficiary of two trusts but only knew about one of them. The second trust came to light during the course of his grandfather's testimony. During the

[32] *Newell v. Newell* 2012 CarswellOnt 7840 at 39
[33] *Jackson v. Jackson* 1997 CarswellOnt 4717 at para. 27, for non recurring capital disbursements, see *Clapp v. Clapp* 2014 CarswellOnt 10739 at para. 31
[34] *F.B. M. v. B.F.* 2019 ONSC 708 at para. 37

trial the grandfather, as trustees, was ordered to make financial disclosure of the second trust including of corporations owned by that trust. [35] Where the existence of the trust interests is known, and acknowledged, before trial disputes about financial disclosure require third party motions. In *Di Luca v. Di Luca*, the court ordered the beneficiary of the trust to bring a third party motion, if required, to compel disclosure from the trust rather than impose that burden and cost on the other spouse.[36] In *Resendes v. Maciel*, the court took a broad approach to financial production from a trust where the husband was trustee of the trust only, and not a beneficiary. In that case the wife was mounting a challenge to the legitimacy of the trust. The court ordered the disclosure as relevant to her allegation that the husband had intermingled his assets with the trust to evade family property obligations and his support responsibilities. [37]

As of 2023, Canada will have new trust reporting rules. Trusts will be compelled to file T3 tax returns even if there is no tax payable and there have not been any distributions. Trusts will be required to disclose annually the identify of trustees, beneficiaries, settlors, and each person who can exert control or override trustee decisions over the appointment of income or capital of the trust. These provisions will create a better paper trail and enhance the ability of family law parties to obtain financial disclosure.

From the practitioner's perspective, it is crucial to determine all trust interests and to disclose them. A marriage contract or separation agreement may be set aside if the

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[35] *F.B.M. v. B.F.* at para. 32
[36] *Di Luca v. Di Luca* 2004 Carswell 767
[37] *Resendes v. Maciel* 2021 ONSC 6421

interests are not disclosed. These interests may be extremely valuable and relevant to all the financial issues in a case: both property and support.

Conclusion

The jurisprudence of family trusts in family law is developing very slowly. It has been hampered by the fact that many of these cases involve high net worth families who choose alternate dispute resolution to protect family privacy. At the same time the undeveloped jurisprudence raises the risk of litigation. There will no doubt be cases that reach the appellate courts eventually in which these challenging issues are resolved. Most parties would sensibly prefer not to be the names on the docket for those cases. In the meantime, counsel must negotiate cases in the shadow of uncertain law.