

TRUSTS IN CANADA

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Rachel L. Blumenfeld, TEP
rblumenfeld@airdberlis.com

David Byun, TEP
dbyun@airdberlis.com

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History of the Trust (Canada)



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History of the Trust (Canada)

- When was the trust introduced into your legal system? What was the driving force behind the introduction of the trust into your legal system?
 - English legal heritage – arose in the medieval courts of equity to provide relief in situations where land was held subject to “use” (i.e. legally held by **A** for the benefit of **B**), and **B** has no recourse to enforce such benefit in the common law courts, since **B** has no legal right to the land.
 - Equity is now embodied in the modern common law
 - All common law provinces of Canada adopted and expanded upon the English common law principles pertaining to the law of trust
 - Quebec, a civil law jurisdiction, accords a different treatment to the trusts.

History of the Trust (Canada)

- Why have trusts become such a common vehicle for wealth preservation and transmission?
 - Tax attributes (for minimization of tax consequences)
 - Probate planning in certain provinces (i.e., alter ego trust, joint partner trust, insurance trust, etc.)
 - Income splitting (i.e., age 40 trust)
 - Tax deferral – but 21-year rule!
 - Capital gains reduction (i.e., family trust – estate freeze, multiplication of lifetime capital gains exemption, etc.)
 - Qualified disability trust, Charitable remainder trust
 - Control purposes (for protection of wealth and consolidation of multiple interests – generally testamentary)
 - Blended family situation (i.e., spousal trust)
 - Delayed & staged distribution to children at a more mature age
 - Spendthrift beneficiary
 - Disabled beneficiary (i.e. Henson trust)
 - Protection of inheritance from matrimonial claims and/or creditors



Main Features of the Trust (Canada)

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Main Features of the Trust (Canada)

- How strong in your jurisdiction are the protections of assets confided to a trustee against the liabilities of: 1) the trustee, 2) the settlor, or 3) the beneficiaries?
 - Trust assets are protected from the creditors of bankrupt or insolvent trustees
 - The trust assets they legally own in their fiduciary capacity are distinct from their personal assets
 - Trust assets are generally protected from the liabilities of the settlor (unless settled to avoid creditors or defeat dependants), provided that the trust is not revocable and the settlor does not retain any control over the distribution of such assets
 - Where the trust is irrevocable and fully-discretionary, the beneficiaries' interests in the trust are generally protected from the claims of their creditors (absent fraudulent conveyance) and/or arising from their relationship breakdowns
 - But, beneficial interest in a trust may be subject to matrimonial claims

Main Features of the Trust (Canada)

- How is title to trust assets registered or otherwise conveyed?
 - a) to the trustee acting as trustee?
 - b) to an entity denominated as a trust?
 - c) to the trustee in the trustee's own name with an obligation of asset segregation to be discharged by the trustee?
- Legal title must be transferred to trustee's name in accordance with the applicable rules of the relevant province in respect of the particular type of property being conveyed.
 - Land is transferred according to the system for the transfer of land in the province, typically involving the use of a deed or a statutory form of transfer and registration.
 - Chattels can be transferred by physical delivery or by deed.
 - Choses in action (i.e. a right enforceable in court) are normally transferred by written assignment.
 - Negotiable instruments (i.e. cheque) are transferred by negotiation and delivery
 - Shares are normally transferred by execution of a share transfer and delivery, subject to requirements under applicable statutes and/or corporate documents. In the case of private company shares, it is important that the settlor must have done all in one's control that is required in order to transfer the shares to a trust.

Main Features of the Trust (Canada)

- What types of investments and assets may a trust formed in your jurisdiction hold?
 - Real estate;
 - Tangible property;
 - Cash;
 - Indebtedness;
 - Stocks;
 - Hedge funds;
 - Private equity funds;
 - Cultural objects;
 - Business start-up;
 - Blockchain and digital currencies;
 - Foreign currencies;

Main Features of the Trust (Canada)

- Does your jurisdiction impose on trustees a duty to diversify assets and to avoid concentration in any one type of asset or industry? Under what circumstances can a trustee hold a single asset (such as a significant equity position in a personally held company) without regard to its long-term economic outlook or prospects?
 - Subsection 27(6) of Ontario's *Trustee Act* stipulates as follows:
 - " A trustee must diversify the investment of trust property to an extent that is appropriate to,
 - (a) the requirements of the trust; and
 - (b) general economic and investment market conditions
 - The Canadian jurisprudence shows that a trustee must diversify trust assets to the reasonable extent, even in provinces where the legislation does not specifically require diversification
 - In the 2014 case of *Miles v. Vince*, the British Columbia Court of Appeal found that a trustee who loaned all insurance trust funds to the family trust failed to comply with the overriding duty to diversify trust portfolio, despite the broad discretionary language in the trust document. The Court noted that diversification is implicit in the prudent investor standard.
 - However, the Trust Deed/Will can permit otherwise

Main Features of the Trust (Canada)

- What is the role of the settlor in the administration of a trust in your jurisdiction? Can the settlor obtain any asset protection benefits if the settlor retains any beneficial interest in the trust or some administrative role such as retaining the power to remove or replace a trustee?
 - Bare trusts (i.e. the use of nominee corporation)
 - Informal trusts (i.e. ITF accounts)
 - Under the *Income Tax Act* (Canada), attribution rules apply where the settlor retains certain rights over trust assets, such as:
 - Trust assets can revert to the settlor
 - Settlor retains the right to determine beneficiaries after the creation of the trust
 - Settlor controls distribution of trust assets
 - i.e. any distribution requires consent of the settlor, who is a sole trustee, or a co-trustee with veto power

Income Tax Act (Canada)

- **75 (2)** If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition
 - (a) that it or property substituted therefor may
 - (i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as "the person"), or
 - (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
 - (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,
- any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.

Main Features of the Trust (Canada)

- What are the roles of beneficiaries in the administration of a trust in your jurisdiction?
 - Do the beneficiaries have a right to compel the trustee to disclose information about a trust?
 - Do the beneficiaries have a right to consent to or otherwise participate in decisions about the management and distribution of a trust?
 - Do the beneficiaries have a right to pursue remedies on behalf of a trustee?
 - Beneficiaries do not generally have a right to participate in the management and distribution of a trust, but have the right to compel the trustees to carry out their duties properly
 - Beneficiaries can compel the trustees to render an accounting with respect to their trust management, regardless of whether there has been any wrongdoing. If the accounting shows any breach, beneficiaries can require the trustees to compensate any negligent losses or retribute improper profits therefrom
 - Beneficiaries, as a general rule, can only bring an action against the trustee (or a person who is deemed a constructive trustee) and do not have the right to bring an action on behalf of the trust, unless under special circumstances such as where the trust is a bare trust, the trustee is unable or unwilling to bring an action against a third party for the trust, or an indirect proprietary claim is available against a third party

Main Features of the Trust (Canada)

- What are the rights of beneficiaries to terminate a trust? Does it make a difference if the beneficiaries are also the settlors?
 - Rule in *Saunders v. Vautier*: a beneficiary who is *sui juris* and whose interest is vested absolutely can terminate a trust and receive trust assets prematurely
 - In the context of *inter vivos* trusts, if a beneficiary is also a settlor, one may revoke a trust if one retained a power of revocation when creating it (but this leads to tax issues)
 - In exceptional cases, a settlor may apply to the court to have a trust set aside on the basis that the trust was made as a result of fraud, undue influence, duress, misrepresentation or mistake.

Main Features of the Trust (Canada)

- What are the prerequisites for serving as a trustee in your jurisdiction?
 - Can an individual ever serve as a trustee?
 - Must a trustee have special expertise in the management and investment of financial assets?
 - Must corporate trustees be organized separately from affiliates that manage or even produce financial products?
 - No formal prerequisites – any individual who is not a minor and does not lack capacity to act in such position (including a non-resident) can serve as a trustee
 - A minor or an individual lacking capacity can be appointed, but cannot deal with trust assets
 - No requirement for special expertise in financial management and investment (apart from the standard of care owed at law)
 - Most provinces do allow private companies to act as trustees with some restrictions

Main Features of the Trust (Canada)

- How strong is a trustee's duty of care in your jurisdiction? Does it exceed the normal duty of good faith and reasonable conduct expected of a party to a contract?
 - Under the Canadian common law, the duty of care that is owed in general by a trustee is that one must exercise the same degree of diligence in managing the trust assets as that which an ordinarily prudent person would exercise in managing his or her own affairs
 - In the context of investments, a trustee is to exercise the same degree of diligence in managing the trust assets as that which an ordinarily prudent person would exercise in managing the affairs of another person
 - A trustee's duty of care with respect to investment, when not governed by a trust instrument, is governed by the statute
 - In Ontario, section 27 of the provincial *Trustee Act* outlines the statutory duty of care, setting out the "prudent investor" standard:

Trustee Act (Ontario)

Investment standards

27 (1) In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments. 1998, c. 18, Sched. B, s. 16 (1).

Authorized investments

(2) A trustee may invest trust property in any form of property in which a prudent investor might invest. 1998, c. 18, Sched. B, s. 16 (1).

Mutual, pooled and segregated funds

(3) Any rule of law that prohibits a trustee from delegating powers or duties does not prevent the trustee from investing in mutual funds, pooled funds or segregated funds under variable insurance contracts, and sections 27.1 and 27.2 do not apply to the purchase of such funds. 2001, c. 9, Sched. B, s. 13 (2).

Common trust funds

(4) If trust property is held by co-trustees and one of the co-trustees is a trust corporation as defined in the *Loan and Trust Corporations Act*, any rule of law that prohibits a trustee from delegating powers or duties does not prevent the co-trustees from investing in a common trust fund, as defined in that Act, that is maintained by the trust corporation and sections 27.1 and 27.2 do not apply. 1998, c. 18, Sched. B, s. 16 (1); 2001, c. 9, Sched. B, s. 13 (3).

Trustee Act (Ontario)

Criteria

(5) A trustee must consider the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:

- 1. General economic conditions.
- 2. The possible effect of inflation or deflation.
- 3. The expected tax consequences of investment decisions or strategies.
- 4. The role that each investment or course of action plays within the overall trust portfolio.
- 5. The expected total return from income and the appreciation of capital.
- 6. Needs for liquidity, regularity of income and preservation or appreciation of capital.
- 7. An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries. 1998, c. 18, Sched. B, s. 16 (1).

Trustee Act (Ontario)

Diversification

(6) A trustee must diversify the investment of trust property to an extent that is appropriate to,

- (a) the requirements of the trust; and
- (b) general economic and investment market conditions. 1998, c. 18, Sched. B, s. 16 (1).

Investment advice

(7) A trustee may obtain advice in relation to the investment of trust property. 1998, c. 18, Sched. B, s. 16 (1).

Reliance on advice

(8) It is not a breach of trust for a trustee to rely on advice obtained under subsection (7) if a prudent investor would rely on the advice under comparable circumstances. 1998, c. 18, Sched. B, s. 16 (1).

Main Features of the Trust (Canada)

- How strong is a trustee's duty of loyalty in your jurisdiction? Does the duty extend not only to the obligation of the trustee to administer the property in the best interests of the beneficiaries but also to pursue business opportunities on behalf of the beneficiaries in preference to the trustee's own financial interest?
 - Trustees are "fiduciaries" – there is no higher standard imposed upon a person by law than the fiduciary duty of loyalty imposed upon a trustee.
 - As part of such duty, a trustee has a selfless obligation to, *inter alia*, always act in the best interests of the beneficiaries, and not to allow one's personal interests to conflict with one's duty as a trustee.
 - If the trustee acquires a profit, it must be disgorged.
 - The trust document may modify the extent of the trustee's duty of loyalty
 - E.g., Wills often include a provision allowing trustees to purchase estate assets without court approval

Main Features of the Trust (Canada)

- What remedies are available, if at all, to disgorge unauthorized profits made by the trustee from the use of trust property or its position as trustee?
 - Beneficiaries have the personal remedy of compelling the trustees to account for their actions with respect to trust assets, regardless of whether there has been any wrongdoing
 - If the accounting shows that the trustees made improper profits from their use of trust assets or through their fiduciary capacity, the beneficiaries can bring an action for an account of profits against the trustees to recover/restitute such gains from breach of trust

Main Features of the Trust (Canada)

- To what extent can beneficiaries in your jurisdiction enforce rights against third parties who receive unauthorized profits or traceable properties obtained from the unauthorized use of trust property or the trustee's position?
 - Beneficiaries can bring a proprietary claim against the recipient third parties to recover the wrongly-transferred trust assets or their traceable proceeds, if such assets or proceeds are successfully followed or traced.
 - This is unless the recipient third party is a *bona fide* purchaser for value and without notice, in which case the recipient acquires the trust assets free of the trust
 - Where the traced proceeds are found to be mixed with funds from different sources in an account and intermediate withdrawals make it difficult to identify the actual proceeds, the two main tracing rules of "presumptions against wrongdoers" and "pro rata sharing amongst innocent contributors" apply



Family Trusts (Canada)

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Family Trusts (Canada)

- Does your jurisdiction provide for the disposition of assets to trusts in Wills or other testamentary instruments? If your jurisdiction has a concept of forced heirship or "mandatory inheritance" can these requirements be satisfied by dispositions in trust for the benefit of the protected or reserved heirs?
 - Assets can be disposed to trusts by testamentary instruments (i.e., testamentary trusts)
 - Canadian common-law provinces have rules relating to spousal rights on the death of one's spouse to make a claim for division of the deceased spouse's property, and also to dependant relief
 - British Columbia – Wills Variation Act
 - Quebec – the automatic right to family patrimony of a surviving spouse
 - In Ontario, a married spouse can elect to receive an equalization of net family property under the provincial family law legislation, instead of receiving the entitlement under the deceased spouse's Will, and a financially dependent family member can bring a dependant's relief claim, which takes precedence over the Will
 - Such requirements can be satisfied by dispositions in trust for the benefit of such potential claimants

Family Trusts (Canada)

- Do trusts in your jurisdiction play a role in the management of assets for the benefit of disabled or incapacitated person?
 - Henson Trust
 - Protects the disabled beneficiary's entitlement to social assistance from the provincial government
 - Completely discretionary
 - Qualified Disability Trust
 - Preferential tax treatment (graduated tax rates)

Family Trusts (Canada)

- If your jurisdiction has an estate, inheritance or gift tax, how are dispositions in trust taxed under these rules?
 - There is no estate, inheritance or gift tax in Canada
 - But: income tax liabilities arising from deemed dispositions at death, and probate fees
 - The 21-year deemed disposition rule
 - Under the *Income Tax Act* (Canada), distribution of trust property can generally be made to Canadian resident beneficiaries on a rollover basis, subject to certain exceptions (i.e. foreign beneficiaries, reversionary trusts, etc.)

Family Trusts (Canada)

- Does your jurisdiction recognize the concept of a revocable trust? If the answer is “yes” can the settlor serve as the sole current trustee of the trust without “merging” the trust property with the settlor and negative the trust itself?
 - Revocable trusts are recognized in Canada
 - Alter ego trusts, joint partner trusts
 - Created and permitted by the *Income Tax Act* (Canada)
 - Settlor (+ spouse) must receive all of the income; only settlor (+spouse) can receive capital while living
 - Often used for probate and incapacity planning
 - Settlor can also serve as the sole current trustee

Contact:



Rachel Blumenfeld TEP
Partner
rblumenfeld@airdberlis.com
T 416.865.3413

Presented by



 **Aird & Berlis LLP** | Lawyers - Brookfield Place, 181 Bay Street, Suite 1800, Toronto, Canada M5J 2T9 T 416.863.1500 F 416.863.1515 | airdberlis.com