

TRUST LAW: A FAMILY LAWYER'S PERSPECTIVE
**VALUATION AND INCOME DETERMINATION OF TRUSTS IN FAMILY
LAW**

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Trusts are flexible vehicles for tax and estate planning, corporate ownership and family income sharing. Because of their versatility, they are widely used. Family lawyers need to be aware of the impact of trust interests to ensure that they are appropriately taken into account in resolving property disputes and the calculation of spousal and child support. While testamentary and *inter vivos* trusts are relatively common amongst people of means there is a paucity of jurisprudence concerning trusts. The limited number of decided cases may be self-perpetuating as the lack of precedent cases raises the stakes for litigants discouraging them from risking an unwelcome outcome in the courts. My review of recent cases in this field has by necessity become a review of *relatively* recent cases. On some issues, such as the types of interests that fall within the definition of family property and how trust income should be calculated for support purposes, there are few decisions at all.

This paper performs sets out the issues raised by trusts in family law cases with the modest goal of assisting counsel in properly identifying, investigating and resolving those issues in accordance with the *Family Law Act* and the *Divorce Act*.

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I. Trust Interests under Part I of the *Family Law Act*

I have restricted the scope of the property questions to Ontario's Act as the issues concerning property settlements are very particular to the legislation in this province. The definition of property and how it or its value are shared after marital breakdown or on death are specific to the legislative scheme set out in the *Family Law Act*.

1. *What is property?*

The first question for counsel is: what interests fall within the definition of property under the *Family Law Act*? The statute provides:

“property” means 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 of a power to consume or dispose of the property, and
- (c) in the case of a spouse's rights under a pension plan that have vested, the spouse's interest in the plan including contributions made by other persons.¹

This is a broad definition apparently designed to encompass the interests of trustees and beneficiaries in trusts. In *Lowe v. Lowe*, the Court of Appeal has cautioned that the definition is not without limitation. Mr. Justice Sharpe writing for the court noted that “property” is simply a right or collection of rights without a single criterion or even a discrete number of criteria. The limits to the definition are to be found in the context of the legislation and its goals. Sharpe J.A. held: “In keeping with the ‘modern’ approach to statutory interpretation, s. 4 should not be read as including any and every interest, even

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

those bearing no relationship to the marriage partnership, simply because that interest is not specifically excluded.”²

Courts have had little difficulty in finding that both legal and beneficial interests may fall within the definition of property under the *Family Law Act*. The trustee has an interest which should be disclosed on his or her financial statement, although that interest may have no value. In *Brinkos v. Brinkos*, the Court of Appeal recognized that a spouse who is the beneficiary of a trust also has a property interest.³ That is so even if the terms of the trust provide that the receipt of the benefit under the trust is postponed. In *Black v. Black*, the husband’s grandfather left him shares in a company. Pursuant to the terms of the grandfather’s testamentary trust, these shares did not vest in the husband until after the date of his marriage.⁴ The court found the beneficial interest was an asset at the date of marriage. Similarly, in *DaCosta v. DaCosta*, the Court of Appeal found that a husband with a residual interest as capital beneficiary of an estate had a property interest.⁵ The contingency of his surviving the beneficiary of the life estate affected value not the nature of the interest.

The statutory definition of “property” expressly addresses powers of appointment by including within the definition of property under the *Family Law Act* property over which a spouse has a power of appointment exercisable in favour of himself or herself.

Similarly, the legislation expressly includes property which a spouse has disposed of but

² *Lowe v. Lowe*, (2006) CarswellOnt 153 (Ont.C.A.) at 8

³ *Brinkos v. Brinkos*(1989), CarswellOnt 2341 (Ont.C.A.)

⁴ *Black v. Black* (1988), CarswellOnt 323 (Ont.S.C.)

⁵ *Da Cpsta v. Da Costa* (1992), CarswellOnt 257 at 14

retains a power to revoke the disposition. The question of whether a spouse who is an object of a power of appointment has a property interest within the meaning of the *Family Law Act* has not been adjudicated.

A discretionary trust or sprinkling trust has some similarities to a power of appointment. The difference is that while the trustees have a power to distribute amongst the beneficiaries, they must execute that power. An individual holding a power of appointment may choose not to exercise it. It may be impossible to predict, however, which of a number of beneficiaries of a trust will receive distributions of trust property and, if they do, in what share. The question as to whether a beneficiary of a discretionary trust has a property interest under the *Family Law Act* has not been adjudicated. It seems reasonable to assume, however, that a court will find that the beneficiary of a discretionary trust has a property interest thereby raising the more difficult question of what value to attribute to that interest.

2. Valuation methods

If a spouse has an interest falling within the broad definition of property under the *Family Law Act* it requires valuation. Trust interests, particularly discretionary trusts, are inherently difficult to value. Value under the *Family Law Act* is not restricted to fair market value but may be understood as value to owner.⁶ The valuation of some beneficial interests are relatively straightforward. For example, a spouse who holds the beneficial interest in real property to which another person has legal title, has an interest

⁶ *Buttrum v. Buttrum*(2001), 15 R.F.L. (5th) 250 (Ont.S.C.J.), *Ward v. Ward* (1999), 44 R.F.L. (4th) 340 (Ont.Gen.Div.)

equivalent to the full value of the asset. More complicated examples are ones that raise more contingencies. A spouse who is the beneficiary of the residual estate under a testamentary trust for which another person enjoys the life interest in the income may have an interest equivalent to the value of the estate less the contingency that the spouse will not survive the life estate beneficiary. The valuator will attribute a discount to reflect the life beneficiary's life expectancy. A further layer of complication arises if the beneficiary of the life estate has a right to encroach on the capital of the estate. These are all issues that require assessment by a qualified business valuator who will have regard to the history of disbursements, amongst other factors.

The more complex the trust arrangement the greater difficulty and, frankly, greater subjectivity inherent in attempting to value the interest. A discretionary trust raises the most obvious valuation problems. The very purpose of a discretionary trust is to permit the trustees to disburse to the beneficiaries as they see fit. A properly drafted discretionary trust permits the trustees to allocate the distributions freely amongst the beneficiaries.⁷ As Donovan Waters states the principle: "Since the trustees may determine which of the members of the class is to have anything under the trust, it follows that the beneficiary is entitled to nothing until it is given to him."⁸ The beneficiary might receive nothing from the trust or perhaps the entire asset. In some cases there may be a history of payments or perhaps a history of no payments. Does the past conduct provide a sufficient basis to value? There are very few cases dealing with this question. In Ontario, the

⁷ Waters, *The Law of Trusts* (Carswell 2nd ed., Toronto, 1984 at 76

⁸ Waters, *supra* at 941

leading decision is that of Madam Justice MacDonald in *Sagl v. Sagl*.⁹ In *Sagl* the husband was one of the beneficiaries of a discretionary trust. He was also a trustee of the trust with the power to appoint or remove trustees of the trust and was a required member of any majority decision of the trustees. The other beneficiaries of the trust comprised his children and grandchildren. The question of whether the interest was property under the Act was not contested. Given Mr. Sagl's dual role as beneficiary and trustee that seems sensible as Mr. Sagl's interest appears to fall within the express statutory definition of property over which the spouse has alone or in conjunction with another person a power to consume or dispose of the property.¹⁰ Madam Justice MacDonald valued Mr. Sagl's interest on the basis of a deemed realization of the trust as of the valuation date and marriage date with an equal division between the capital beneficiaries at each date. Five capital beneficiaries existed at the date of marriage and seven at the date of separation. Madam Justice MacDonald included the value of one-fifth of the trust in Mr. Sagl's assets as a date of marriage deduction and one-seventh of the trust in his assets as of the date of separation.

In *Kushnir v. Lowry*, Madam Justice Snowie took the same approach to valuing a trust in which the wife, Ms. Kushnir, was a beneficiary along with her daughter. Snowie J. included one half the value of the trust on a deemed realization at the date of separation in Ms. Kushnir's net family property.¹¹ I have found no cases in Ontario that diverge from the *Sagl* approach which has the attraction of simplicity. The ease of application of this approach does not dispel the rather troubling question of fairness to both parties. The

⁹ *Sagl v. Sagl* (1997), CarswellOnt 2144 (Ont.Gen.Div.)

¹⁰ *Family Law Act*, s. 4(1), "property" (b)

¹¹ *Kushnir v. Lowry* (2004) CarswellOnt 530 (Ont.S.C.J.) at 12

spouse who holds the beneficial interest may grossly overpay or grossly underpay his or her equalization obligation calculated on the assumption that she or he will receive a *pro rata* share of the trust assets. Mr. Sagl had an unusual degree of control over the Sagl family trust as both trustee and beneficiary. However, where a beneficiary of a discretionary or sprinkling trust is not also a trustee, that individual has no guarantee of any recovery.

3. *May a court impose an “if and when” division of a beneficial interest?*

As with other troublingly indeterminate assets, such as defined benefit pensions and stock options, one approach to the valuation conundrum is a court ordered “if and when” division. This was the solution in *Da Costa*, in which the Court of Appeal ordered Mr. Da Costa to pay a portion of his contingent interest to his wife if and when he received it.¹² Since the *Da Costa* decision, however, the Supreme Court of Canada’s decision *Best v. Best* has cast doubt on the availability of an if and when division scheme under Part I of the *Family Law Act* where the arrangement defers not only the payment of the equalization amount owing but circumvents calculating what is owing.¹³ More recently in *Ross v. Ross*, the Ontario Court of Appeal overturned a lower court decision providing for the division of stock options on an if and when basis. The majority of the Court of Appeal held that this approach is inconsistent with the scheme of Part I of the *Family Law Act* which requires a calculation of the value of an asset at the date of separation not a division of the receipts after the fact.¹⁴ While *Best* concerned the division of a pension

¹² *Da Costa, supra*

¹³ *Best v. Best* (1999) CarswellOnt 1995 (S.C.C.) at 66

¹⁴ *Ross v. Ross*(2006) CarswellOnt 7786 (Ont.C.A)

and *Ross* the division of proceeds of a stock option, the underlying principle does not seem distinguishable from a contingent or discretionary trust interest.

4. *Trusts settled during the marriage*

A separate line of cases have considered whether a spouse may legitimately settle assets on a trust during his marriage. A transfer made with the intention of defeating a spouse's claim for equalization may be set aside as a fraudulent conveyance.¹⁵ In *Hockey-Sweeney v. Sweeney*, the Court of Appeal held that where a spouse settled a trust during the marriage for the benefit of the children, a not uncommon event, the assets do not form part of that spouse's net family property.¹⁶ On the other hand, if the spouse retains control over the assets under trust as a question of fact, then the assets will be included in that spouse's net family property.¹⁷ It seems that the creation of trusts during a marriage to implement legitimate estate and trust planning objectives will withstand scrutiny as long as the trusts are irrevocable.

II Trust Interests under the *Divorce Act* and Part III of the *Family Law Act*

1. *The Calculation of Trust Income for Child Support Purposes*

The Federal *Child Support Guidelines* and their Ontario counterpart provide a legislative scheme for the determination of income. A spouse's income for child support principles is presumptively found using the sources of income in line 150 of his or her tax return.¹⁸

¹⁵ *Stone v. Stone*, [2001] O.J. No. 3282 (Ont.C.A.)

¹⁶ *Hockey-Sweeney v. Sweeney*(2004), CarswellOnt 4422 (Ont. C.A.), leave to appeal dismissed, (2005) CarswellOnt 1431 (S.C.C.)

¹⁷ *Lampron v. Lampron*(2003) CarswellOnt 5062 (Ont.S.C.J.) at 11

¹⁸ *Federal Child Support Guidelines*, s. 16

Pursuant to s. 19 of the *Guidelines* a court has the discretion to impute income to a spouse, where appropriate. S. 19(1)(i) provides:

19(1) Imputing Income – 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.¹⁹

Where a spouse receives taxable income from a trust, reported on his or her tax return, there is no need to resort to s. 19(1)(i). Trust income actually paid and received will be presumptively included for child support purposes under s. 16. S. 19(1)(i) is available as a tool to impute income to a spouse who is the beneficiary of a trust but not receiving distributions from that trust or if the spouse is receiving capital disbursements that do not form part of his or her taxable income. This section has been used sparingly by the courts. For example in *Jackson v. Jackson*, the court ordered a spouse to pay interim child support based on the receipt of a capital payment from a trust. Pardu J. held that as there was a substantial history of using capital to support lifestyle on an interim basis capital should be imputed to the husband for the purpose of calculating child and spousal support. He acknowledged, however, that on a permanent basis the wife may have to accept a reduced lifestyle.²⁰ The decision in *Jackson* is particular to its facts and must be approached with some caution. Imputing income on the basis that a spouse should consume his or her capital whether held in a trust or not seems contrary to the goals of the *Guidelines* which are designed to calculate support payments based on income.

¹⁹ *Federal Child Support Guidelines*, s. 19(1)(i)

²⁰ *Jackson v. Jackson* (1997) CarswellOnt 4717 (Ont.C.J.)at 7

In *Waese v. Bojman*, Madam Justice Mesbur considered the income of a payor mother. She was the beneficiary of a testamentary trust along with her children. The terms of the trust permit the trustees to supplement the mother's income to a maximum amount, net of taxes. The mother had previously not received any disbursements from the trust because her own income from other sources exceeded the ceiling set by the trust terms. Mesbur J. concluded that in the current year as the mother's income fell below the maximum, and in light of her good relationship with the trustees, that income to the maximum amount allowable under the trust be imputed to her.²¹ In the same proceeding, the father and the children sought orders against the trust requiring the trustees to make distributions to the children and to vary the trusts, among other claims for relief. The trustees had refused to make any disbursements at all to the children from the trust. The children argued that the trustees had failed to exercise their discretion appropriately. Noting that all the relief other than that for child support concerned trusts and estate issues, Mesbur J. ordered that the trusts and estates application be transferred to the Estates list. This proceeding continued in the Estates court with decisions by Carnwath J. on disclosure and Cullity J. on interim disbursements.²² Based on the interim record before him, Mr. Justice Cullity determined that it was probable that one of the trustees had not recognized his fiduciary obligation to the children and not exercised his discretion. Cullity J. ordered interim disbursements of \$150,000 to the children and an increase in the child support payable by the mother to the eldest child who was in attendance at university. Cullity J. opined that

²¹ *Waese v. Bojman*(2001) CarswellOnt 1813 (Ont.S.C.J.) at 4

²² *Waese v. Bojman* (2002) CarswellOnt 5216 (Ont.S.C.J.)

the trustees should have considered making greater disbursements to the children to obviate the need for the mother to pay child support.²³

Decisions pursuant to s. 19(1)(i) are limited in number and perhaps inevitably peculiar to their facts. *Waese v. Bojman* is unusual in that the trustees and the other beneficiaries of the trust were also parties to the child support application. Their participation permitted a more nuanced resolution of the dispute, at least in the preliminary skirmishes for which there is a public record. Without the participation of these other interested parties, there is a risk that a court will make a support order based on the imputation of income from a trust while the trustees persist in refusing to make disbursements to the beneficiary spouse.

2. *The Calculation of Trust Income for Spousal Support Awards*

The determination of spousal support does not turn so closely on income as that of child support. Trust income, as with other income or capital, forms part of a spouse's means and financial circumstances to be taken into account by a court in establishing an appropriate quantum of spousal support. Trust income or the potential for trust income likely will have no connection to the parties' marriage. There is a lesser justification for imputing trust income to a spouse as the basis for a spousal support award than for a child support award. In the case of child support, the courts have clearly indicated a desire to ensure that children benefit from all the parents' financial resources. As with *Waese v. Bojman*, the children may with some frequency also be co-beneficiaries with a parent of a family trust. No such factors militate that a spouse receive a share in the other party's

²³ *Waese v Bojman, supra*, at 14

trust interests. Where a family trust has been the source of a lifestyle enjoyed during the marriage, however, such as in *Jackson*, it is more likely that a court will impute income to the beneficiary spouse in order to continue the benefits enjoyed by the other spouse, at least for a transitional period.

DISCLOSURE

1. What information is discoverable?

Family law applications involving trust interests, whether relevant to support or property, pose particular disclosure problems. To properly evaluate the interest the parties and the court will need extensive disclosure. To determine the nature and value of a trust interest under Part I of the *Family Law Act*, counsel require: the trust deed, financial statements for the relevant period of three to five years before the valuation date and/or date of marriage where relevant, trust tax returns for the same period, a statement of the trust assets held and a history of disbursements both capital and income. Where a trust holds corporate interests disclosure of the nature and value of those interests is also necessary. To support an exclusion claim, the documents and circumstances surrounding the establishment of the trust may be relevant. For support purposes the same information is required. The difficulty is that the beneficiary may not have all these documents in his or her possession and control. Where a spouse is a beneficiary of a trust the broad requirements for disclosure under the *Family Law Act* suggest that he or she should take active steps to secure this information. If the trustees refuse to make the required disclosure despite the best efforts of the beneficiary, the other spouse must resort to a motion for third party disclosure, pursuant to the *Family Law Rules*.

2. Process

Under the *Family Law Rules*, a court may compel a third party to provide documentary disclosure or to attend for examination.²⁴ If a party wishes to either examine a trustee or trustees, or compel production of relevant documents, then that party may bring a motion for that relief served on the opposing party and the third party. The relevant factors for the court hearing the production motion are:

- a. the importance of the documents in the litigation;
- b. whether production at the discovery stage of the process rather than at trial by way of summons is necessary to avoid unfairness to the applicant;
- c. whether the discovery of the parties on the issues is adequate;
- d. the availability of the documents or information sought;
- e. the relationship of the third parties to the parties in the litigation. Non-parties with allied interests to a party are more susceptible to a production order than a true “stranger” to the litigation.²⁵

²⁴ S.19(11) of the *Family Law Rules* provides: **Document in Non-Party’s Control** –If a document is in a non-party’s control, or is available only to the non-party, and is not protected by a legal privilege, and it would be unfair to a party to go on with the case without the document, the court may, on motion with notice served on every party and served on the non-party by special service,

- (a) order the non-party to let the party examine the document and to supply the party with a copy at the legal aid rate; and
- (b) order that a copy be prepared and used for all purposes of the case instead of the original.

S. 20(5) **Order for Questioning or Disclosure** – The court may, on motion, order that a person (whether a party or not) be questioned by a party or disclose information by affidavit or by another method about any issue in the case, if the following conditions are met:

1. It would be unfair to the party who wants the questioning or disclosure to carry on the case without it.
2. The information is not easily available by any other method.
3. The questioning or disclosure will not cause unacceptable delay or undue expense.

Family Law Rules, O.Reg. 114/99, as am.

²⁵ *Ontario (Attorney General) v. Ballard Estate* (1995), 26 O.R. (3d) 39 (Ont.C.A.) interpreting the comparable provision s. 30.10 of the *Rules of Civil Procedure*, cited with approval in the family law context by Mr. Justice Nelson in *Noik v. Noik* (2001) CarswellOnt 324 (Ont.S.C.J.) at 31

The authority of the court under the *Family Law Rules* to order appropriate relevant disclosure in a family law proceeding against the trustees of a trust may well in an appropriate case exceed what a beneficiary could demand from the trustees under relevant trust law principles.

In Conclusion:

Over twenty years after the introduction of the *Family Law Act* and ten years after the *Child Support Guidelines*, the intersection of trust and family law remains a very undeveloped area of the jurisprudence. The lack of clear guidance places the onus on counsel to deal with trust issues arising in cases thoughtfully and in a manner consistent with the broader principles of family law. I suggest that progress in developing the case law in this area would be assisted by greater dialogue between counsel in the disciplines of family and trusts law.