

attorney who wishes to continue to make annual contributions at that level on the grantor's behalf will not be able to do so in any year where the income derived from the grantor's property over which the attorney has control is less than \$50,000. (If the income were to fall short in any given year, the attorney would have to apply to a court for an order permitting the usual donation to be made in that year.)

Recall that the making of charitable gifts by an attorney on behalf of an incapable grantor falls under the category of "optional expenditures". If the grantor has any concerns as to whether the attorney will in fact continue the grantor's past philanthropic practice, what can be done? The answer is simple. The grantor need only ensure that the CPA contain mandatory instructions to the attorney that such charitable gifts be made. In that case, the statute states that "the instructions shall be followed". In this way, the intended charitable gifts would no longer be optional, but would instead be mandatory, and the grantor could be assured that his or her philanthropic goals would continue to be met after a loss of mental incapacity. (There are two caveats on the mandatory nature of the instructions. First, the attorney may not make those charitable gifts if they would adversely affect the ability of the attorney to make the mandatory expenditures referred to above. Second, the previously-mentioned income threshold to support the quantum of the charitable gift in each year must be met.)

The moral of the story? If an individual wishes to ensure that his or her philanthropic objectives will continue to be met after becoming mentally incapable, a CPA can be put in place containing the requisite instructions to the attorney to continue to make the grantor's desired charitable gifts. (Indeed, one might go further and advise the intended charity that one's CPA contains such instructions. Armed with that information, the charity will be in a position to monitor the attorney's actions to see that the grantor's philanthropic wishes are carried out.)

POWERS TO ADD AND REMOVE TRUST BENEFICIARIES — INCOME TAX CONSIDERATIONS — PART II

By Elie S. Roth* and Michael Goldberg**

While the CRA has issued a number of rulings and technical interpretations stating its administrative position relating to the addition of a discretionary beneficiary of a trust pursuant to an amendment power or variation of trust, or the exercise of a power to add beneficiaries contained in the deed of settlement of the trust, it does not appear to have been entirely consistent in its ruling position. For example, an advance income tax ruling dated January 1, 2008 appears to have considered a fact pattern involving the addition of a newly incorporated corporation and a registered charity as beneficiaries pursuant to the exercise of an amendment power contained in the deed of settlement of the discretionary trust. The CRA ruled that the existing beneficiaries would not thereby be considered to have received any proceeds of disposition for purposes of the *Income Tax Act*¹ ("the Act") as a result of the trustees' exercise of their power of appointment to add the two new beneficiaries.²

Similarly, the CRA has issued a number of rulings confirming that in circumstances where the trust deed already includes a discretionary class of potential corporate beneficiaries that meet certain defined criteria, the incorporation of a new corporate beneficiary that falls within the class should not give rise to a disposition of interests in the trust by the existing beneficiaries or in a resettlement of the trust.³ Surely this analysis is correct: it is

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¹ R.S.C. 1985, c.1 (5th Supp.).

² See CRA document number 2007-0255961R3, dated January 1, 2008.

³ See, for example, CRA document number 9719943, dated January 1, 1998, in which the CRA ruled that subsection 107(2) would apply to allow a rollover to a Canadian resident corporation that became a beneficiary upon its incorporation by the

no different, in substance, from the birth of an individual who falls within the class of beneficiaries, whether comprised of children or issue of a named beneficiary. It is difficult to distinguish, either in substance or from a policy perspective, between this position and the CRA's position that the addition of a new corporate beneficiary owned by the individual beneficiaries under the trust or of a class of potentially qualifying corporate beneficiaries to the discretionary class could be considered to result in a disposition by the remaining discretionary beneficiaries of their interests in the trust.

The CRA's administrative position on adding discretionary beneficiaries is difficult to support, and it has been criticized by numerous commentators on various grounds, including the following:⁴

- The addition of a new beneficiary to a discretionary class does not, as a matter of law, result in any transfer or disposition of rights from the existing to the new beneficiaries, and thus should not be considered to involve a disposition of any interest of the existing beneficiaries in the trust. Unless and until the trustees exercise their discretion in favour of a particular beneficiary, discretionary beneficiaries do not have a proprietary interest in the trust property, but only the right to compel due administration of the trust, including that appropriate consideration be given to the exercise of the trustees' discretionary powers.⁵ Adding an additional discretionary beneficiary

trustees as it qualified under the class of corporate beneficiaries provided for in the trust deed. In that case, the trustees retained voting non-participating shares, with non-voting participating shares issued to the non-resident individual beneficiary. The CRA also confirmed that GAAR would not apply in respect of the distribution. See also CRA document number 2008-0267251R3, dated October 22, 2008.

⁴ See Donovan Waters, "The Power in a Trust Instrument to Add and Delete Beneficiaries" (2012), 31 E.T.P.J. 173; and Tim Youdan, "Income Tax Consequences of Trust Variation, Revocable Trusts and Powers of Appointment" (2005), 24 E.T.P.J. 141.

⁵ *Gartside v. Inland Revenue Commissioners* (1967), [1968] A.C. 553 (U.K. H.L.); *Vestey v. Inland Revenue Commissioners* (No. 2), [1979] 2 All E.R. 225 (Ch. D.), affirmed (1979), [1980] A.C. 1148 (U.K. H.L.).

does not reduce or diminish the interest of any existing beneficiary of the trust.

While the CRA refers to the definition of "disposition" in subsection 248(1) in support of its position, the definition does not expressly extend to this circumstance, and it is difficult to see how the exercise of a power to add a beneficiary can be considered to be a transaction or event entitling the existing beneficiary to proceeds of disposition of the trust interest. In the 2002 CRA ruling, for example, the remaining beneficiaries did not even consent to the amendment, which was made by the corporate settlor and trustees pursuant to the amendment power in the deed of settlement of the trust. In the absence of an express deeming provision in the Act, the beneficiaries should not be considered to have disposed of a discretionary interest they may have in the trust as a result of steps taken by third parties.

Even if the existing discretionary beneficiaries could be considered to have disposed of their discretionary interests, there appears to be no justification for allocating a *pro rata* value to the interest of a discretionary beneficiary, as there is no reasonably precise manner in which to determine the fair market value of a discretionary interest in a trust. It is generally impossible to determine the likelihood of the power being exercised in favour of a particular object and any amount that might be paid as a result of an exercise of discretion on this basis.

While the CRA cited the family law decision in *Sagl v. Sagl*⁶ as support for its valuation approach, the family law context is not directly comparable to the determination of fair market value for purposes of the Act. In particular, in the family law context the determination of "fair value" is a subjective one, unlike in the income tax context, where the determination of fair market value looks to objective factors to determine the arm's-length market price for the property in an open and unrestricted market. In the

context of a discretionary trust interest, this market simply does not exist.

Moreover, the *Sagl* decision appears to have very limited, if any, precedential value. The court accepted the *pro rata* approach to valuation in that case, which was a compromise submission put forward by the husband's counsel, and thus accepted the position that the husband put forward for valuation of his interest in the trust for matrimonial purposes. Furthermore, in addition to being an income and capital beneficiary under the trust, the husband had the power under the trust deed to appoint and remove trustees, and was specifically required by the terms of the trust to form part of the majority of trustees approving distributions. He therefore had significantly more control over the trust than discretionary beneficiaries may have in otherwise comparable circumstances. Family law decisions in other jurisdictions have not subsequently followed the approach in the *Sagl* case, instead adopting alternative approaches to valuation.⁷

The CRA refers to even-hand considerations in determining that

⁷ The issue of how to value a contingent interest in a discretionary trust has, for example, been considered in the following family law decisions:

Grove v. Grove, 1996 CarswellBC 644, [1996] B.C.J. No. 658 (B.C. S.C.), additional reasons 1996 CarswellBC 2602 (B.C. S.C.) (the court applied an "if and when" approach to valuation, ruling that the spouse was entitled to 20 percent of any capital assets that were distributed by the trust to the other spouse); *Kachur v. Kachur* (2000), 274 A.R. 323 (Alta. Q.B.) (the court examined the purpose of the trust to determine whether the contingent beneficiaries would receive a trust distribution and if so, the amount that they would receive);

Delesalle v. Delesalle (2006), 57 B.C.L.R. (4th) 112 (B.C. C.A.) (the court dismissed the argument that a beneficiary of a discretionary trust owned an interest in the trust, thereby suggesting that the value of this trust interest was nil); and

LeVan v. LeVan (2006), 82 O.R. (3d) 1 (Ont. S.C.J.), additional reasons (2006), 82 O.R. (3d) 1 at 76 (Ont. S.C.J.), affirmed (2008), 90 O.R. (3d) 1 (Ont. C.A.), additional reasons 2008 ONCA 505 (Ont. C.A.), leave to appeal refused [2008] 3 S.C.R. viii (note) (S.C.C.) (the court adopted a valuation that applied a discount rate that was the same as the discount rate applied to minority shareholdings).

a *pro rata* value may be appropriate, but this appears to be irrelevant. In the context of a discretionary trust, the conferral of discretion on the trustees by the settlor constitutes an express exclusion of the even hand principle, except to the extent that the trustees are required to give *bona fide* consideration to the exercise of their discretion.

The CRA's position leads to inconsistent and inappropriate results. For example, when a trust has a class of individual discretionary beneficiaries, and a beneficiary dies or is born, it has never been suggested that this should result in a disposition of the interests of the existing beneficiaries for purposes of the Act, yet there appears to be little substantive basis for distinguishing between these events and the addition of a new beneficiary to a class pursuant to an existing power to add beneficiaries. Similarly, if there is a transfer of beneficial interests where a new beneficiary is added to a discretionary class pursuant to an exercise of the power, would a charitable donation result from the addition of a charitable beneficiary to the discretionary class? The CRA presumably would not accept this result.

Finally, from a policy perspective it is difficult to see why the CRA should seek to impose tax on the addition of a beneficiary, as there is no undue deferral in respect of any gain inherent in the trust property — it will remain to be taxed on the 21-year deemed disposition date or upon a disposition or deemed disposition of the property in the hands of the individual beneficiary or, in the case of a corporate beneficiary, in the hands of the shareholder of the corporation.

These issues warrant further consideration by the CRA, with a view to developing an approach that is capable of practical application on a consistent basis, takes account of the nature of a discretionary beneficiary's trust interest, and provides taxpayers with greater certainty from a planning perspective. While the CRA's position with respect to the subsequent addition of discretionary beneficiaries to

⁶ (1997), 31 R.F.L. (4th) 405 (Ont. Gen. Div.), additional reasons (1997), 35 R.F.L. (4th) 107 (Ont. Gen. Div.).

a trust appears to be incorrect, the risk that the CRA would apply the positions it has expressed in the context of a variation or exercise of an amendment power or specific power to add beneficiaries in order to subsequently add beneficiaries under the trust, potentially resulting in adverse tax consequences to the existing beneficiaries or the trust arising from a deemed disposition at that time, may tend to support the inclusion of a broader initial class of discretionary beneficiaries under the trust at the time of settlement in circumstances where the potential future flexibility this entails may be a significant consideration in the implementation of the planning.

Part II – PARBs: Other Income Tax Considerations

In Part I of this paper, we reviewed and critically considered the CRA's administrative position that the addition of a new beneficiary pursuant to a power to add beneficiaries results in a variation of the rights of existing beneficiaries under the trust, who would be considered to have disposed of part of their existing interests in the trust to the newly added beneficiary for purposes of the Act. In Part II of this paper we review certain other tax issues that the use of powers to add and remove beneficiaries ("PARBs") can potentially give rise to, but which have not been the subject of significant commentary to date.

In particular, this section of the paper will consider:

1. Whether a trust agreement containing a PARB could result in an expanded group of persons being determined to be "beneficially interested" in the trust pursuant to subsection 248(25);
2. Specific provisions in the Act that may apply if the use of PARBs in a trust agreement expands the group of "beneficially interested" persons; and
3. Some comments made in *obiter* in recent case law that, if followed, could lead to an extended application of the term "beneficially interested" even where that defined term is not used in the relevant statutory provisions, and thereby further expand the ambit of other provisions of the Act that may apply if PARBs are utilized in trust agreements.

Prior to publishing a series of articles on this subject in 2013,⁸ there had been very little written about any of these topics in the context of PARBs. It is likely that this had been the case because the use of PARBs has traditionally been an offshore trust practice; if properly structured, such trusts should not have been subject to Canadian income taxation or to the specific provisions of the Act discussed below. However, due to the growing acceptance of PARBs as being appropriate for use in Canadian trusts,⁹ a more in-depth review of these topics is warranted.

PARBs and Subsection 248(25)

Meaning of Beneficially Interested

The logical starting place for this discussion is to examine some of the more relevant provisions of the term "beneficially interested" as it is defined in subsection 248(25) of the Act, which are reproduced as follows:

For the purposes of this Act,

- (a) a person or partnership beneficially interested in a particular trust includes any person or partnership that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under a trust to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more trusts or partnerships;
- (b) except for the purpose of this paragraph, a particular person or partnership is deemed to be beneficially interested in a particular trust at a particular time where
 - (i) the particular person or partnership is not beneficially interested in the particular trust at the particular time,

- (ii) because of the terms or conditions of the particular trust or any arrangement in respect of the particular trust at the particular time, the particular person or partnership might, because of the exercise of any discretion by any person or partnership, become beneficially interested in the particular trust at the particular time or at a later time, and

- (iii) at or before the particular time, either

(A) the particular trust has acquired property, directly or indirectly in any manner whatever, from

(I) the particular person or partnership,

(II) another person with whom the particular person or partnership, or a member of the particular partnership, does not deal at arm's length,

(III) a person or partnership with whom the other person referred to in subclause (II) does not deal at arm's length...

Paragraph 248(25) (a) – "Beneficiary" Provisions in Canadian Discretionary Family Trusts

Many, if not most, traditional Canadian discretionary family trusts define the term "beneficiaries" in a manner that will result in the creation of a determinable class of beneficiaries. For example, the beneficiaries might be limited to the "issue" of a specific person, or corporations owned by one or more of the issue of that person. Is such a discretionary beneficiary beneficially interested in the trust for purposes of paragraph 248(25)(a)?

Based on arguments put forward in an article by Guy Fortin,¹⁰ there should be a reasonable position to answer the foregoing question in the negative. In particular, M. Fortin notes as follows:¹¹

¹⁰ Guy Fortin, "Strangers in Strange Lands: The Hidden Traps of Offshore Trusts," in *Report of Proceedings of the Fifty-First Tax Conference, 1999 Conference Report* (Toronto, Canadian Tax Foundation, 2000) 40:1-68, at pp. 11-17.

¹¹ *Ibid.*, p. 12.

⁸ See Michael Goldberg, "Not Quite Chicken Soup: Are Powers to Add and Remove Beneficiaries Safe for Canadian Family Trust Precedents?," Part I, 2174 *Tax Topics* (CCH) 1-3 (November 7, 2013), and Part II, 2175 *Tax Topics* (CCH) 1-3 (November 14, 2013).

⁹ Donovan Waters, "The Power in a Trust Instrument to Add and Delete Beneficiaries" (2012), 31 E.T.P.J. 173, at pp. 190-191, and anecdotal experience of the authors.

Under a discretionary trust, where the trustee is obliged to distribute the whole of the income (or capital or both) among the potential beneficiaries in the manner that he or she sees fit, the interest of the beneficiary cannot be described as a proprietary right. It is merely a limited personal right to be considered as a potential beneficiary that can be exercised only against the trustee. The right of a beneficiary under a non-exhaustive discretionary trust is even more limited in that, under such a trust, the trustee can choose whether and to what extent a distribution is to be made at all. However, it appears from an examination of the doctrine and jurisprudence on this issue that despite the legal nature of the interest of a beneficiary under a discretionary trust, in practice the language of a particular statutory provision may be drafted in a manner that is broad enough to bring within its ambit the non-proprietary interest referred to above. In the context of tax law, the result may well be that the non-proprietary interest of a beneficiary under a discretionary trust could be covered by the definition. As will be noted below, it appears that Parliament, in enacting the 1997 amendments to the definition of "beneficiary interested," implicitly took the position that the former definition was not broad enough to include the non-proprietary interest.

It should be noted that the amendments referred to above relate to paragraph 248(25)(b), as only modest changes were made to paragraph 248(25)(a) pursuant to the 1997 amending legislation. In this regard, M. Fortin concludes with respect to paragraph 248(25)(a) that:¹²

[T]he right to receive property or payment is not a conditional right to property, the existence of which is subject to the exercise of the trustee's discretion, but is, rather, a completely separate right that arises only from the moment that the trustee chooses to exercise his or her discretion. In other words, there are two distinct rights at stake: (1) the right to be considered by the trustee and (2) the right to property in the event that the trustee exercises his or her discretion.

Nonetheless, as will be discussed in detail below, in the *Propep*¹³ decision the Federal Court of Appeal appears to have assumed that not only is a discretionary beneficiary beneficially interested in a trust for

purposes of paragraph 248(25)(a), but also that a person whose only right to become a beneficiary is as a consequence of an exercise of discretion could also be considered to have a beneficial interest in a trust within the meaning of this provision.

This interpretation of paragraph 248(25)(a) is extremely problematic, and we respectfully suggest that it must be incorrect. First, as discussed below, it disregards the existence of paragraph 248(25)(b), which does appear to be broad enough to apply both to discretionary beneficiaries and to persons who may become beneficiaries upon the exercise of certain discretionary powers. Second, if this interpretation is correct then in the case of a trust agreement that includes a PARB, theoretically every person in the world could have a beneficial interest in that trust.

This result cannot possibly be consistent with a purposive analysis of paragraph 248(25)(a). Accordingly, it is hoped that Canadian courts will ultimately impose reasonable limits in interpreting paragraph (a) of the "beneficially interested" definition. Unfortunately, the limited judicial consideration of the provision — consisting of the comments made in *obiter* by the Federal Court of Appeal in *Propep* and, more recently, those of the Tax Court of Canada in *Lyrtech*¹⁴ — has to date failed to do so.

Part III of this article will appear in the 30-12 issue of Money & Family Law, to be published in December 2015

VARIATION OF SPOUSAL SUPPORT ON RETIREMENT — PART I

By Thomas Dart*

As we know, the issue of spousal support continues to be contentious despite the creation of the *Spousal Support Advisory Guidelines*. The cost of litigating these issues is frequently disproportionate to the amounts involved. This is particularly so when a paying spouse seeks to reduce or eliminate the amount of spousal support based upon his or her retirement.

As others today are dealing with the issue of "double-dipping", this paper focuses more on what can we do, in the face of the law on variation, to protect our payor clients and our recipient clients? How best to structure the inevitable variation application?

Bryan Smith has written an excellent paper dealing much more broadly with this topic. This paper was presented at a Law Society of Upper Canada program held on October 30, 2014, presented by the Law Society of Upper Canada entitled "Understanding Pensions in Family Law". This paper can add nothing to his excellent review of the law. Therefore, it deals only with a general overview of the retirement issue and how we might more appropriately craft agreements which provide more direction when the need for variation arises.

Many couples seem to have separated in their early 50s after many years of marriage. At that point, they usually have elder children either just commencing university or just completing it. Many come to an agreement which is incorporated in the usual domestic contract. Sometimes the provisions of the

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¹² At pp. 14-15.

¹³ *Propep Inc. v. R.*, 2009 D.T.C. 5170 (Fr.), 2010 D.T.C. 5088 (Eng.) (F.C.A.), leave to appeal refused 2010 CarswellNat 506 (S.C.C.).

¹⁴ *Lyrtech RD inc. v. R.*, 2013 D.T.C. 1054 (Fr.), 2013 D.T.C. 1147 (Eng.) (T.C.C. [General Procedure]), affirmed 2014 CarswellNat 4604 (F.C.A.).