

Family trusts: Weighing the true value of a discretionary interest

Date: March 08, 2019

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This article was originally published by *The Lawyer's Daily* (www.thelawyersdaily.ca), part of LexisNexis Canada Inc. [Click here](#) to view the PDF file.

What is the dollar value of an interest in a discretionary family trust for equalization purposes under Ontario's *Family Law Act*?

The starting point is whether a beneficiary spouse's interest in a discretionary family trust constitutes "property" pursuant to the Act's provisions. Unfortunately, family courts have not been consistent in their approach to the issue and continue to grapple with whether or not such an interest constitutes property or a mere expectancy.

Adding to the complexity is the fact that even though the settlement of a family trust is generally intended and regarded as a gift, an interest in a discretionary family trust is not necessarily "excluded property" when determining net family property.

To be sure, a consistent history of distributions in favour of a beneficiary spouse from the family trust simplifies the analysis. However, more often than not the payments are occasional and wholly discretionary, with the beneficiary's spouse's parents frequently serving as trustees who have the sole power to determine quantum and frequency. Not surprisingly, faced with a separation affecting a beneficiary, they're inclined to turn off the tap entirely.

Family courts, then, have taken three distinct approaches to valuing an interest in a discretionary trust:

- The "fair value" approach: the court examines the fair market value of a beneficiary spouse's interest in the family trust by asking how much such an interest would bring on the open market;
- The "pro rata" approach: the court divides the capital in the trust by the number of beneficiaries, allocating a proportionate value to the beneficiary litigant;

- The “historical analysis” approach: after analyzing the circumstances surrounding the settlement of the trust, the historical distributions therefrom and the beneficiary spouse’s relationship to the trust during the marriage, the court assigns a value for equalization purposes as at the date of separation.

Because all these approaches have significant limitations, the question of whether a better way exists looms consistently over the jurisprudence. And the short answer is: not yet.

The Supreme Court of Canada in *S.A. v. Metro Vancouver Housing Corp.* 2019 SCC 4 earlier this year, however, does offer some guidance. The court had to decide whether a beneficiary who was also a co-trustee (along with her sister) had an absolute interest in a Henson trust. In its analysis, the court focused on the *degree of control* exercised by the beneficiary.

Ultimately, the court decided that being a trustee was not the sole defining factor in determining whether an individual had an absolute interest in a trust. Rather, the court ruled, judges should consider a number of factors on the issue of control, including:

- Whether the beneficiary could compel payments from the trust;
- Whether the beneficiary could wind-up the trust in accordance with the rule in *Saunders v. Vautier* (1841), Cr. & Ph. 240, 41 E.R. 482; and
- Whether the beneficiary received regular payments from the trust, or whether he or she had only a “mere hope” of receiving distributions.

Although *S.A. v. Metro Vancouver* did not engage family law, there appears to be no reason why the principles cited therein are inapplicable where the issue involves the *degree of control* exercised by the beneficiary spouse of a family trust. The upshot is that a determination of the degree of control along the lines of the SCC decision is now likely central to valuing a discretionary interest. We know from the case law, however, that trust law will generally give way to family law, particularly when opposing counsel is vociferously beating the drum of the “best interests of the children.”

The takeaway is that basic trust principles of settlor, trustee and beneficiary do not necessarily apply in the same way in family law cases engaging a discretionary family trust as they might in other types of litigation.

That’s not surprising, perhaps, because family courts are fundamentally concerned with “the equitable settlement of the affairs of the spouses upon the breakdown of the partnership” (preamble to the *Family Law Act*) as opposed to whether or not a family law litigant has a “mere hope” or “expectancy” in receiving distributions from a family trust.

What all this means is that counsel in family law cases must undertake a thorough investigation of the beneficiary spouse’s relationship to the trust. The starting point is always the deed of trust or trust agreement: to what extent does the document demonstrate that the beneficiary client controls the trustees, either directly or indirectly?

Examining the trust documents, however, is but the first step in determining the degree of control. Here, it’s important to note that the list of factors mentioned by the SCC in making that

determination is not exhaustive, but inclusive. *Tremblay v. Tremblay* 2016 ONSC 588, which preceded *S.A. v. Metro Vancouver*, provides a useful overview of appropriate considerations for a court, including:

- evidence about the founding intent of the trust: was the trust designed to allow control by the beneficiary?;
- composition of trustees, including whether the beneficiary was a trustee;
- veto powers in decision making, including whether a weighted majority vote in favour of the beneficiary existed;
- history of trustee decisions and exercise of discretion demonstrating direct or indirect control by the beneficiary;
- power of the beneficiary to remove trustees or to appoint additional trustees; and
- relationship of beneficiaries to the trustees: are the trustees independent and at arm's length or are they family members who may not act independently?

Still, there remains both a paucity of jurisprudence and inconsistencies in the case law dealing with the valuation of discretionary interests in a family trust. Consequently, the need for careful case by case analysis — one in which knowledge of both trust and family law is critical — persists.

As it turns out, the task can be daunting and managing client expectations (along with the expectations of family members) can be arduous. Legal and accounting fees can become an important consideration, as evidenced in *Plese v. Herjavec* 2018 ONSC 7749 by Justice Ruth Mesbur (now retired), who noted that the process of tracing distributions from the family trust had been a “full time job for two people for three months” — and surely one where an imprudent strategy by counsel inexperienced in the arena where family law meets trust law can impact severely.