Property Held by Discretionary Trusts and the *Family Law Act*

This paper considers the division of property held by discretionary trusts as described by paragraph 85(1)(f) of the *Family Law Act* (the “FLA”) following the breakdown of a relationship.¹

I have focused on this narrow issue because it will have startling consequences unless the provisions in the FLA relating to discretionary trusts are changed. This paper does not discuss property of trusts that is family property that is not excluded property under paragraph 84(2)(f) or subsection 84(3).

In short, the FLA presumes that to the extent that property held by a discretionary trust grew in value during a particular relationship, that property notionally belongs to the beneficiary who separates from a spouse and that spouse for the purposes of the division of property rules that apply upon the end of that relationship.

The impact of this astonishing presumption will largely be determined by how judges of the Supreme Court of British Columbia (the "Supreme Court") interpret section 95 which gives them discretion to order an unequal division of family property to avoid a result that leads to significant unfairness.

It is unenviable task to speculate on how new legislation will be interpreted. The provisions of the FLA might be interpreted in a fashion which will make my concerns completely unfounded. After all, who would have guessed that the application of the *Fraudulent Conveyance Act* (British Columbia) does not require any fraud?²

**Legislative History of the FLA**

The FLA was passed in the BC legislature on November 23, 2011 and received Royal Assent on November 24, 2011. However, most of the provisions of the FLA will be brought into force by regulation. BC Regulation 131/2012 brings most of the provisions of the FLA into force on March 18, 2013.

On November 24, 2011 section 90 (which deals with the obligation to support a parent) and section 120.1 (which deals with property agreements) of the *Family Relations Act* (the "FRA") were repealed by section 258 of the FLA.

**Property Held by Discretionary Trusts is Excluded Property**

Paragraph 85(1)(f) provides that:

property held in a discretionary trust

(i) to which the spouse did not contribute,

¹ *Family Law Act*, SBC 2011, c.25, s.258.

(ii) of which the spouse is a beneficiary, and

(iii) that is settled by a person other than the spouse,

is "excluded property" with the result that the amount by which the value of that property increased since the later of the date that the relationship between spouses \(^3\) began or the excluded property was acquired is a family asset for the purposes of the property division rules.

Clauses (i) through (iii) in paragraph 85(1)(f) succinctly describe most discretionary family trusts commonly used in estate planning in British Columbia which have been established so that they are not reversionary trusts under subsection 75(2) of the *Income Tax Act* (the “ITA”). Accordingly, unless amended, paragraph 85(1)(f) will have wide application and wide ramifications with respect to discretionary trusts created both before and after the March 18, 2013 coming into force date of the property division rules of the FLA.

The phrase "discretionary trust" is not defined in the FLA. An interesting question is whether a discretionary trust would include a trust such as a spousal trust where the trustees have discretion to encroach upon capital and on the death of the spouse the dispositive powers are completely discretionary.

All references in this paper to discretionary trusts are to discretionary trusts as defined in paragraph 85(1)(f). All references to statutory provisions are to the FLA unless stated otherwise.

**Excluded Property**

The use of the term "excluded property" is an unfortunate misnomer. Excluded property is not excluded from the division of property rules in the FLA.

Excluded property is defined in section 1 to be property that would otherwise be family property but is excluded under section 85. Section 85 lists the types of property that is excluded property.

Paragraph 84(2)(g) includes in family property the amount by which the value of excluded property has increased since the later of the date:

1. the relationship between the spouses began, or

2. the excluded property was acquired.\(^4\)

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\(^3\) As discussed later, section 3 defines "spouses" for the purposes of the FLA and that definition includes certain common-law partners.

\(^4\) In the case of property owned by a discretionary trust, presumably this means the date that the spouse/beneficiary became beneficially interested in the trust.
Spouses Under the FLA

Spouses and relationships between spouses are defined in section 3. Spouses consist of married persons and, for the purposes of the property division rules, a person who has lived with another person in a marriage-like relationship and has done so for a continuous period of at least two years.\(^5\)

In the case of a common-law relationship, the relationship begins on the date on which the common-law partners began to live together in a marriage-like relationship even though the common-law partners do not become spouses until they have lived together for two years.

All references in this paper to “spouses” are to spouses as defined in the FLA.

Relevant Provisions of the FLA

The relevant provisions in the FLA which provide that property held by a discretionary trust is excluded property are:

1. section 1 defines excluded property as follows:

   "excluded property" means property that would otherwise be family property but is excluded under section 85 [excluded property];

2. section 81 creates a right to family property on separation:

   Subject to an agreement or order that provides otherwise and except as set out in this Part and Part 6 [Pension Division],

   (a) spouses are both entitled to family property and responsible for family debt, regardless of their respective use or contribution, and

   (b) on separation, each spouse has a right to an undivided half interest in all family property as a tenant in common, and is equally responsible for family debt.

3. paragraph 84(1)(a) is the relevant part of subsection 84(1) for the purposes of this analysis:\(^6\)

   (1) Subject to section 85 [excluded property], family property is all real property and personal property as follows:

   (a) on the date the spouses separate, property

      (i) that is owned by at least one spouse, or

      (ii) in which at least one spouse has a beneficial interest;

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\(^5\) Note the significant differences between a “common-law partner” defined in subsection 248(1) of the ITA and the FLA definition of spouses who are not married.

\(^6\) Paragraph 84(1)(b) of the FLA is a substituted property rule.
4. paragraph 84(2)(g) includes as family property the growth in value of excluded property during the period that property was owned during the relationship:

(2) Without limiting subsection (1), family property includes the following: …

(g) the amount by which the value of excluded property has increased since the later of the date:

(i) the relationship between the spouses began, or

(ii) the excluded property was acquired.

5. paragraph 85(1)(f) provides that:

(f) property held in a discretionary trust:

(i) to which the spouse did not contribute,

(ii) of which the spouse is a beneficiary, and

(iii) that is settled by a person other than the spouse

is excluded from family property.

Application of Paragraph 85(1)(f)

One might argue that by applying a technical meaning to the phrase "family property is all real and personal property … in which at least one spouse has a beneficial interest" as used in subsection 84(1) suggests that paragraph 85(1)(f) has no application to property held by discretionary trusts.

The analysis is as follows:

1. It is trite trust law that the beneficiary of a discretionary trust does not have an interest in trust property or a contingent interest in the trust but only has a mere expectancy.

2. Therefore, an interest in a discretionary trust is neither property owned by at least one spouse as required by subparagraph 84(1)(a)(i) nor something that a spouse has a beneficial interest in as required by subparagraph 84(1)(a)(ii).

3. Therefore, if an interest in a discretionary trust could not be family property in the first instance, then it cannot be excluded property as defined in section 1.

However, I think that there is little doubt that this interpretation will not prevail because paragraph 85(1)(f) will be interpreted in a non-technical manner that does not render it a nullity based on basic rules of statutory interpretation. The analysis is as follows:

7 A similar argument exists that an interest in a family trust cannot be a "family asset" for the purposes of the FRA because it is not property but that argument has never been accepted by the Courts.
1. Generally, when a word or expression has both an ordinary non-technical meaning and a technical meaning, the ordinary non-technical meaning is presumed. This is because it is presumed that the legislature wishes to be understood by the citizens.

2. Statutory interpretation includes a presumption against tautology. It is presumed that the legislature avoids meaningless words. Every word in a statute is presumed to make sense and to have a specific role in advancing the legislative purpose.

3. The phrase "beneficial interest" is used in a common rather than a technical fashion in other legislation and arguments that a technical meaning to beneficial interest should be applied in other legislation have been rejected by the courts.

A more fulsome discussion of the application of paragraph 85(1)(f) is contained in schedule “A”.

**Burden of Proof**

Subsection 85(2) provides that a spouse claiming that property is excluded property has the burden of proof of doing so.

**Significance of Discretionary Trust Property Being Excluded Property**

There may be little or no significance to property owned by a discretionary trust being excluded property.

This is best explained by an example. Assume that:

1. a trust was settled with a $10 bill;
2. the $10 was used to acquire 100% of the common shares of a holding company;
3. at the time that the trust was created, its beneficiaries included a beneficiary who is a "spouse" as defined in section 3;
4. 10 years after the trust was created a spouse/beneficiary separated from his or her spouse when the property division rules of the FLA applied; and
5. the common shares of the holding company are worth $1 million at the time of the Supreme Court hearing relating to the division of property.

If the shares of the holding company are excluded property, then the divisible value of the shares would be $999,990. If the shares are family property that is not excluded property, then the divisible value of the shares would be $1 million. The excluded property status of the trust property would give the spouse/beneficiary $5 of protection in this example.
Accordingly, the less time between the date that a trust was created and:

1. the date that a spouse/beneficiary entered into a relationship that subsequently gave rise to a separation; or

2. the spouse/beneficiary became a beneficiary of the trust,

the less important the distinction between excluded property and other family property.

**Triggering Event: Separation**

Under the FLA, the time for determining whether property is "family property" is at the date of separation of married spouses as well as unmarried spouses who have lived in a marriage-like relationship for at least two years. Subsection 83(1) states that spouses are not considered to have separated if, within one year after separation, they begin to live together again with the primary purpose of reconciling and they continue to live together for one or more periods totaling at least 90 days.

**Underlying Legislative Policy**

Typically discretionary trusts are established by, or at the direction of, parents for the primary benefit of their children. For a multiplicity of good reasons, parents often create trusts for their children rather than making gifts to their children.

When a parent makes a gift to a child who is a spouse, then only the growth from the date of the gift in value of the property given to the child is family property.

On the other hand, if the parent includes a child who is a spouse as a beneficiary a discretionary trust, then the current provisions of the FLA *prima facie* treat the addition of the spouse as a beneficiary as if the property of the trust had been given to that particular child irrespective of the interests of the other beneficiaries of the trust; a mere expectancy is treated in the same fashion as the receipt of a gift!

The underlying policy attempts to give the spouse who was not a beneficiary the certainty with respect to the value of a spouse/beneficiary’s interest in a discretionary trust yet that spouse/beneficiary has no such certainty that he or she will receive any value from the trust.

**Transitional Rules**

The transitional rules relating to division of property rules under the FLA are found in section 252. Those rules provide that:

1. the FRA will continue to apply to agreements or orders made before the FLA comes into force thereby ensuring that property division disputes that have been resolved under the FRA may not be reopened by virtue of the new rules in the FLA; and
2. where a property division proceeding has been started under the FRA, it will be determined under the FRA unless the parties agree otherwise.

I understand that the reason for the lengthy period between Royal Assent of the FLA and the coming into force of the property division rules was so that common-law partners would have time to enter into cohabitation agreements relating to the division of property or separate before the coming into force of the FLA’s property division rules.8

**Consequences**

**Disposition on Separation?**

Paragraph 81(b) provides that subject to an agreement or order and except as set out in the property and pension division rules, on separation, each spouse has a right to an undivided half interest in all family property as a tenant in common and is equally responsible for family debt.

Although there remains genuine uncertainty, the generally accepted view is that a triggering event under subsection 56(1) of the FRA which creates an undivided half interest in the family assets as a tenant in common constitutes a disposition for the purposes of the ITA. However, not much turns on this for the purposes of the ITA where the family asset is capital property because of subsection 73(1.1) of the ITA which provides for greater certainty that the rollover rules in subsection 73(1) of the ITA apply where the transfer by a taxpayer of property to the taxpayer's spouse was the result of provincial law.9

Paragraph 81(b) would be terribly problematic if it created an immediate disposition to a spouse/beneficiary and that person's spouse in respect of the property of a discretionary trust. As the transfer would be from the trust rather than a spouse, the rollover in respect of capital property in subsection 73(1) of the ITA would not apply. Presumably, the rollover of property from the trust to the spouse beneficiary under subsection 107(2) of the ITA would normally apply. That subsection could not apply to a spouse who was not a beneficiary.

Fortunately, it appears that in the case of excluded property, paragraph 81(b) only creates a right to family property without creating a disposition for the purposes of the ITA. Sections 96 and 97 remove any doubt in this regard because:

1. section 96 provides that excluded property may only be divided by an order of the Supreme Court in only very limited and defined circumstances;

2. section 97 sets out how the Supreme Court actually effects a division of family property (assuming the spouses do not do so be agreement), which make it clear that a subsequent order of the Supreme Court is required to convey property interests; and

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8 This is why section 120.1 of the FRA which deals with property agreements was repealed by the FLA with immediate effect on Royal Assent; this removed the disincentive to enter into cohabitation agreements under section 120.1 of the FRA.

9 Subsection 73(1.1) of the ITA also applies to transfers that because of a decree, order or judgment of a competent tribunal made in accordance with that provincial law.
3. sections 96 and 97 are the exceptions to the general rule referred to in the preamble in section 81.

Equal Right to Discretionary Trust Property

Even if paragraph 81(b) does not create a disposition, paragraph 81(b) has startling implications with respect to the property of a discretionary trust because the starting point for the division of assets upon separation is that each of the spouses has a right to an undivided half interest in the growth in value in all of the property of a discretionary trust that occurred during the relationship.

For instance, assume that a discretionary trust has 50 beneficiaries, the trust acquired shares of a family corporation for nominal consideration concurrently with its creation and, at that time, the beneficiaries included married individuals and individuals in common-law relationships. Pursuant to paragraph 81(b) as a starting point each such beneficiary and that beneficiary's spouse who separate and bring an action under the FLA after March 17, 2013 have a right to an undivided half interest in virtually all of the trust's property.

Does a Separation Prevent a Trustee from Dealing with Trust Property?

Once such a separation occurs, can the trustees of a discretionary trust thereafter deal with trust property because of the rights that have been created for the separated spouses under the FLA?

Does the separation effectively freeze the ability of trustees to administer the trust?

If so, this could give a very significant tactical advantage to the spouse who is not a beneficiary of the trust following separation.

Consider for example a separation that occurred shortly before a trust's 21st anniversary. Would this preclude the trustees of the trust from undertaking the steps normally taken to avoid a deemed disposition of trust property?

A separation may not prevent the trustees of the discretionary trust from thereafter dealing with trust property for three reasons:

1. Section 91 gives the Supreme Court authority to make interim orders restraining a spouse from disposing of any property at issue but that authority is not extended to third parties such as trustees of a discretionary trust.

2. Section 96 provides that the Supreme Court must not order a division of excluded property subject to the limited exceptions in paragraphs 96(a) and (b).

3. Section 97 describes the types of orders that the Supreme Court can make to effect a division of family property implying that such an order is necessary to convey property of a discretionary trust.

Nevertheless, unless the FLA is amended trustees will be in an untenable position that will often be exacerbated by the difficulty of determining if and when a separation occurred.
Prohibition Against Division of Excluded Property

Although spouses have an equal right to family property under paragraph 81(b), section 96 provides that the Supreme Court must not order a division of excluded property unless:

1. family property or family debt located outside British Columbia cannot be practically divided; or

2. it would be significantly unfair not to divide excluded property on consideration of
   a. the duration of the relationship between the spouses; and
   b. a spouse's direct contribution to the preservation, maintenance, improvement, operation or management of excluded property.

The implications of section 96 are best understood by an example.

Assume that at the time of the Supreme Court hearing, the fair market value of the spouses’ family property was $2 million consisting of a family home worth $1 million and property of a discretionary trust worth $1 million. Assuming an equal division of assets, the non-beneficiary spouse would receive the family home while the spouse/beneficiary would notionally receive the property of the discretionary trust. This would be an extraordinary result which could have potentially devastating impact on:

1. the spouse/beneficiary if the trust property was not distributed to that beneficiary; or

2. the other beneficiaries of the discretionary trust if the trust property was distributed to that beneficiary.

Unequal Division

I have referred to the creation of an undivided half interest in trust property as a tenant in common under paragraph 81(b) as a starting point only because of subsection 95(1) which provides that the Supreme Court may order an unequal division of family property or family debt, or both, if it would be significantly unfair to:

1. equally divide family property or family debt, or both, or

2. divide benefits as required under Part 6 [Pension Division].

For the purposes of subsection 95(1), the Supreme Court may consider the following factors in considering whether an equal division of family property would be unfair:

1. the duration of the relationship between the spouses;

2. the terms of any agreement between the spouses, other than an agreement described in section 93 (1) [setting aside agreements respecting property division];

3. a spouse's contribution to the career or career potential of the other spouse;
4. whether family debt was incurred in the normal course of the relationship between the spouses;

5. if the amount of family debt exceeds the value of family property, the ability of each spouse to pay a share of the family debt;

6. whether a spouse, after the date of separation, caused a significant decrease or increase in the value of family property or family debt beyond market trends;

7. the fact that a spouse, other than a spouse acting in good faith,
   a. substantially reduced the value of family property, or
   b. disposed of, transferred or converted property that is or would have been family property, or exchanged property that is or would have been family property into another form, causing the other spouse's interest in the property or family property to be defeated or adversely affected;

8. a tax liability that may be incurred by a spouse as a result of a transfer or sale of property or as a result of an order; and

9. any other factor, other than the consideration referred to in subsection 95(3) which relates to spousal support, that may lead to significant unfairness.

The first eight factors all relate to spouses and their relationship. Only the ninth factor can permit a judge of the Supreme Court to consider the interests of third parties (i.e., the other beneficiaries of a discretionary trust) in determining fairness.

The crucial issue with respect to property held by discretionary trusts is the extent to which the Supreme Court judges will order unequal divisions of family property where the property includes property held by discretionary trust based on the significant unfairness to the other beneficiaries of the trust who were not a party to the division of family property proceedings. How will the Supreme Court weigh the interests of the spouses against the interests of the beneficiaries of the trust who are not party to the FLA dispute?

**Income Tax Consequences of a Transfer to Non-Beneficiary Spouse**

It is noteworthy that if the Supreme Court makes an order under section 96 for the division of excluded property, then it has wide authority to effect that order under section 97 including an order to transfer property to a spouse who is not a beneficiary.

If this occurred, then paragraph 69(1)(b) of the ITA could deem the trust to have received fair market value proceeds of disposition if a non-beneficiary spouse who is still married to the spouse beneficiary acquires an interest in trust property because paragraph 251(1)(b) of the ITA would deem the still-married spouse of the spouse beneficiary to deal with the trust, which would be a "personal trust" for the purposes of the ITA, on a non-arm's length basis and because "separation" for the purposes will occur before a divorce.
It is not obvious that this would apply in the case of a breakdown of a common-law relationship because, at the time of the breakdown, the "other" common-law partner would not be deemed to deal with the trust on a non-arm's length basis which in turn is necessary for a fair market value disposition for the purposes of 69(1)(b) of the ITA.

In either case, the non-beneficiary spouse would be subject to an income inclusion under subsection 105(1) of the ITA if the Canada Revenue Agency interpreted that provision in a literal fashion in these circumstances.

If a spouse/beneficiary was an income, but not capital, beneficiary of a trust, then the transfer of the trust property to the income beneficiary would not occur on a tax-free basis under 107(2) of the ITA.

In the case of a spouse/capital beneficiary, arguably 107(2) of the ITA would permit the transfer to occur on a tax-free basis in some circumstances; however, it is arguable that the rollover in 107(2) of the ITA would not be available because the distribution was not in satisfaction of the spouse/beneficiaries capital interest in the trust.

Finally, the non-beneficiary spouse would remain liable under subsection 160(1) of the ITA for certain unpaid tax amounts of the trust. Such vicarious liability would be avoided if the property was transferred from spouse to spouse pursuant to an order or written agreement under subsection 160(4) of the ITA.

**Valuation**

Section 87 provides much needed clarity with respect to how and when assets are valued.

First, paragraph 87(a) provides that the value of family property must be based on its fair market value.

Second, paragraph 87(b) provides that fair market value must be determined as of the date an agreement dividing family property is reached or of the hearing before the court respecting the division of property.

However, in the case of discretionary trusts, perhaps the important valuation rule is in paragraph 85(1)(f) itself which makes it clear that it is the trust property, and not the interest in the discretionary trust, which is the excluded property and therefore which is valued.

**Agreements Concerning Division of Family Property**

Subsection 94(2) prevents the Supreme Court from making an order respecting the division of property that is already dealt with by an agreement unless the agreement may be partly or completely set aside in accordance with section 93.

Section 93 only permits an agreement to be set aside if the agreement was not procedurally fair at the time it was made or, even if the agreement was procedurally fair, the substance of the agreement is significantly unfair.
An agreement will not be procedurally fair at the time it was made if:

1. a spouse failed to disclose significant property or debts, or other information relevant to the negotiation of the agreement;

2. a spouse took improper advantage of the other spouse's vulnerability, including the other spouse's ignorance, need or distress;

3. a spouse did not understand the nature or consequences of the agreement; and

4. other circumstances that would, under the common law, cause all or part of a contract to be voidable.

An agreement may be "significantly unfair" having regard to the criteria set out in subsection 93(5):

1. the length of time that has passed since the agreement was made;

2. the intention of the spouses, in making the agreement, to achieve certainty; and

3. the degree to which the spouses relied on the terms of the agreement.

Therefore, the Supreme Court's discretion to ignore, in whole or in part, procedurally fair agreements relating to the division of family property will be limited to three specific criteria which must result in the agreement being "significantly unfair".

**Substituted Property Rule**

Paragraph 85(1)(g) provides that "property derived from property or the disposition of property referred to in any of paragraphs (a) to (f)" is excluded property.

Discretionary trusts commonly distribute trust property on a tax-deferred basis to capital beneficiaries in partial or complete satisfaction of their capital interest in the trust pursuant to subsection 107(2) of the ITA.

Accordingly, if a discretionary trust was to distribute a securities portfolio to a beneficiary, then the securities portfolio would remain excluded property. Intermingling of property distributed from a trust to a beneficiary might result in the loss of that status notwithstanding paragraph 85(1)(g) because subsection 85(2) puts the burden of proof on that spouse beneficiary for demonstrating that property is in fact excluded property.
What is the Likely Response of the Supreme Court with Respect to Discretionary Trusts?

The White Paper on Family Relations Act Reform\(^\text{10}\) (the "White Paper") stated at page 81:

> The most compelling reasons for moving to an excluded property regime are to make the law simpler, clearer, easier to apply, and easier to understand for the people who are subject to it. The model seems to better fit with people's expectations about what is fair.

The White Paper also stated that "[t]he Family Relations Act's division of property regime has been criticized for being so flexible that outcomes are difficult to predict"\(^\text{11}\) and that:

> British Columbia's current law relies heavily on judicial discretion to sort out property division disputes. The existing statute provides a general framework for dividing property but relatively few detailed rules. As well, in British Columbia, judges have significant discretion with regard to dividing property unequally at the distribution stage. While experienced family lawyers are familiar with the developments from the case law, the governing law is relatively inaccessible to spouses without lawyers. The broad discretion in the existing Act makes it harder to predict outcomes. This uncertainty, in turn, can fuel and prolonged disputes.

While the FLA may well achieve these objectives with respect to other types of property, it will not achieve these objectives with respect to the treatment of property of discretionary trusts.

The comments of a member of the British Parliament speaking about the Irish Home Rule bill in 1889 come to mind in regard to the provisions relating to the property of discretionary trusts in the FLA:

> it sweats difficulties at every paragraph; every clause ends in a cul-de-sac; dangers lurk in every line; mischiefs abound in every sentence and an air of evil hangs over it all.

On the other hand, it is fair to say that the Supreme Court has had great difficulty in dealing with interests in discretionary trusts under the FRA. Although not a British Columbia case, in Sagl v Sagl, [1997] OJ No. 2837 (OCJ Gen. Div.) the value of a husband’s capital interest in a discretionary trust was determined to be equal to 1/5th of the liquidation value of the trust because he was one of five capital beneficiaries. Macdonald, J. acknowledged that this \textit{pro rata} valuation of the interest in the trust would be "turning trust law upside-down".

The non-tax issues that I think will be exceedingly important in how the Supreme Court will apply the division of property rules with respect to discretionary trusts are as follows:

1. Can a trustee deal with trust property after a beneficiary has had a separation with the result that that beneficiary and his or her spouse each have a right to an undivided half interest in the trust property?

2. Does potentially disentitling the other beneficiaries of a discretionary trust constitute a basis for an unequal distribution of family property as regards the property of a discretionary trust?


\(^{11}\) See page 79 of the White Paper, ibid.
I believe that the net effect of the FLA as regards to interests in discretionary trusts will significantly change the dynamics of dispute relating to the division of family property.

Absent the application of a deeming rule under the FRA, I would argue the spouse who was not a beneficiary of a discretionary trust was in a worse position than a spouse who was a beneficiary with respect to arguing that an interest in the family trust was a family asset and even if that was a family asset, what value would be put to the interest in the trust.

Under the FLA, I suspect that a spouse who is a beneficiary of a discretionary trust will be in a worse position than a spouse who was not a beneficiary because the interest in the trust's property will be an excluded asset and as a starting point, the other spouse will have a notional right to an undivided interest to the property of the trust.

What Can be Done with Respect to Discretionary Trusts and the FLA?

Given the uncertainty with respect to how the Supreme Court will treat interest in discretionary trusts for the purposes of the division of property rules in the FLA and the effect of lack of transitional rules what can be done?

Do Not Rely on Highly Technical Strategies

An experienced family lawyer would caution against using the type of highly technical strategies which are commonly used in day-to-day tax planning. History has shown that judges of the British Columbia courts are highly interventionist and jealously protect their discretion to do what they view as fair particularly in the context of family law.12

Avoid the Other Spouse Making Contributions to Trust Property or Being a Trustee

Section 96 only permits the Supreme Court to order a division of property in two circumstances. One of the circumstances is where it would be significantly unfair not to divide excluded property on consideration of:

1. the duration of the relationship between the spouses, and

2. a spouse's direct contribution to the preservation, maintenance, improvement, operation or management of excluded property.

Accordingly, by excluding spouses from contributing to the preservation, maintenance, improvement, operation or management of trust property (which prevents the spouse from being a trustee or for example, an employee or director of a corporation owned by the trust), an order cannot be made to divide the trust property under paragraph 96(b). This would only permit the division under paragraph 96(a) which is where family property or family debt located outside of British Columbia cannot practically be divided.

12 For example, many family lawyers believe that the decision in Francis v. Francis, 53 BCLR (3d) 50 (BCSC) is a good example of good facts making bad law. In that case, many argue that the legal necessities were ignored to obtain a fair result.
Avoid Trusts Where the Only Object is Income Splitting

Do not use discretionary trusts when the only object is to income split. Use dividend sprinkling share structures. Normally, the shares of a separate class of non-voting, dividend sprinkling shares have little or no value. Further, sometimes to further address the valuation issue such shares are often redeemable for their paid-up capital.

Delay Acquisition of Beneficial Interest: Power to Appoint Beneficiaries

Consider using trusts which permit the addition of beneficiaries at a later date because paragraph 84(2)(g) only includes in family property the value of excluded property that has increased since the later of the date the relationship between the spouses began and the date that the excluded property was acquired. In the case of a discretionary trust, one would expect, that the excluded property would be acquired on the date that the spouse became beneficially interested in the property.

Domestic Agreements

The effectiveness of domestic agreements has become more certain under the FLA. Agreements that are procedurally fair at the time that they are made and not significantly unfair at the time the property is to be divided having regard to:

1. the length of time that has passed since the agreement was made;

2. the intention of the spouses; and

3. the degree to which the spouses have relied upon the agreement,\(^\text{13}\)

will be enforced.

Exclude Certain Beneficiaries of Existing Trusts

Does it make sense to simply exclude your children as beneficiaries altogether? The children might be subsequently added as beneficiaries. The Canada Revenue Agency has stated that the addition of a beneficiary to a discretionary trust pursuant to a power of amendment requiring the agreement of the settlor and all the trustees:

1. did not result in a disposition of a property of the trust;

2. did not result in the application of subsections 56(2) or 105(1) of the ITA;

3. resulted in a disposition of a portion of each beneficiaries’ interest in the trust at the time of the variation; and

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\(^{13}\) Sometimes, the trustees of a discretionary trust will request that a beneficiary and his or her spouse enter into an agreement prior to the distribution of property to the beneficiary that attempts to preclude that asset from the division of family assets upon a breakdown of the relationship. Assuming that the spouse could not be seen to have taken improper advantage of the other spouse’s vulnerability, will this assist in protecting the asset distributed by the trust?
4. the value of each beneficiary’s interest in the trust would be proportionate based on the “even-handed principle” i.e., the value of each beneficiary’s interest was approximately equal.14

Most practitioners have a considerable amount of skepticism with respect to these last two points. The proposition that an amendment of a trust gives rise to a disposition of the interests of the beneficiaries in the trust is contrary to numerous rulings given by Canada Revenue Agency. The argument that the even-handed principle means that the fair market value of each beneficiaries interest in a discretionary trust is worth an equal share of the proportionate value of the trust is wrong; further assuming such an interest was even capable of being sold, who would pay anything for such an interest? No one would. It is noteworthy that the Canada Revenue Agency was not considering the addition of a beneficiary to a trust pursuant to a pre-existing power to add beneficiaries but rather amending the terms of the trust to add a beneficiary.

Define Beneficiaries to Exclude Spouses or Spouses Without Domestic Agreements

Does it make sense to define beneficiaries to include:

a. children who are not "spouses" for the purposes of the FLA; or

b. children who are "spouses" for the purposes of the FLA but who have entered into a written agreement excluding the property of the trust as family property which are, in the opinion of counsel, not capable of being set aside under section 93 of the FLA?

The problem with a provision described in (b) above is that courts are terribly protective of their own jurisdiction and are unlikely to accept such a description of beneficiaries which effectively results in an attempt to take away the court’s jurisdiction in determining whether or not the agreement was effective under section 93.

Make Your Children's Spouses the Only Beneficiaries

Consider making your children's spouses, but not your children, the beneficiaries of a discretionary trust because this places your children’s spouses, but not your children, in the worse position by virtue of being a beneficiary of a discretionary trust should there be a separation. A power to add beneficiaries would be useful in these circumstances. If necessary income splitting with children could still be achieved through the use of separate classes of dividend sprinkling shares which could easily be designed to have nominal value.

Avoid Reliance on Deeming Provisions

A provision in a trust indenture which purports to deem a particular person not to be a beneficiary immediately before a separation occurs for the purposes of the FLA would be ineffective. The Tax Court of Canada decision in Nussey Estate v. R, 99 D.T.C. 1211, [2000] 2 C.T.C. 228415 is an

14 CRA document no. 9209655, July 22, 1992
example of the limitations associated with a deeming provision. In deciding that a provision in a shareholders agreement which attempted to deem shares to have been redeemed by a company one day preceding a shareholder’s death was ineffective, O’Connor T.C.J. referred to the statement made by Bonner, T.C.C.J. at page 1182 in his judgment in Wood v. Minister of National Revenue (1988), 88 D.T.C. 1180 (T.C.C.):

A legislature has the power to enact deeming provisions. Others do not.

The problem with such a provision is that it cannot re-create history.

**Stack Discretionary Trusts**

If the property of the trust was another interest in a discretionary trust, then the excluded asset would be the interest in a discretionary trust and the fair market value of such an interest is nominal at most.

**Special Shares**

Classes of shares can be designed which have rights and restrictions that are akin to interests in discretionary trusts. Such shares have little if any value. The partition of property rules in the FLA look through the interest in a discretionary trust to the underlying trust property but there is no such rule with respect to shares.

**Conclusion**

I am strongly of the view that the FLA provisions relating to property owned by discretionary trusts must be amended because as enacted these provisions will:

1. rely heavily on judicial discretion on a case-by-case basis to resolve disputes involving spouses who are beneficiaries of discretionary trusts;

2. fail miserably in an attempt to make the law simpler, clearer, easier to apply and easier to understand; and

3. not fit with people's expectations about what is fair because these provisions, *prima facie*, treat the mere possibility of receiving a benefit from a discretionary trust in the same fashion as a gift that has actually been made.

At a minimum, the FLA needs to be amended to:

1. specifically provide that a separation does not result in a disposition in respect of excluded property that is property of a discretionary trust because the rollovers provided for in subsections 73(1) and 107(2) of the ITA can never apply to a disposition from a trust to a person who is not a beneficiary;

2. specifically provide that a separation of a spouse/beneficiary does not prevent the trustees of the trust from dealing with trust property in a bona fide manner but perhaps only prohibits the trustees of the trust from distributing trust property to the spouse/beneficiary who has separated from his or her spouse;
3. specifically provide that the interests of the other beneficiaries of the trust must be considered before any order can be made under section 96 to divide excluded property that is property of a discretionary trust;

4. provide specific factors in respect of excluded property that is property of a discretionary trust for the purposes of an unequal division made pursuant to subsection 95(1) which would include the terms of the discretionary trust, who was responsible for the increase in value of the trust property, the circumstances behind the creation of the discretionary trust, the reasonable expectations of the other beneficiaries of the discretionary trust, the tax consequences to the discretionary trust of an equal division and whether other beneficiaries of the discretionary trust may separate from their spouses; and

5. specifically provide for "as and when orders" as granted in the Supreme Court decision in *Grove v. Grove*, March 27, 1996 No. D091687 Vancouver Registry, in subsection 97(2) which require that distributions made by a discretionary trust to a spouse/beneficiary to thereafter be treated as excluded property.

Without changes of this nature, the division of property rules in the FLA relating to property held by discretionary trusts would likely be the most momentous development in the law of trusts to have occurred in British Columbia.

Finally, as an endnote, I want to comment on how easy it is to criticize legislation and how hard it is to draft it. “Lawyers hate to draft and love to edit.” The drafters of the FLA have done a terrific job. The drafting is clear and concise. With respect to this narrow issue, they were tasked with the unenviable task of trying to fix something that our courts have been struggling with for years.
Narrow Interpretation: A Nullity?

Applying a technical meaning to the phrase "family property is all real and personal property … in which at least one spouse has a beneficial interest" used in section 84(1) suggests that paragraph 85(1)(f) has no application to the property held by discretionary trusts based on the following analysis:

1. The definition of "excluded property" in section 1 requires that the property would otherwise be family property but for an exclusion in section 85 so that if property is not family property in the first instance, it cannot be excluded property.

2. It is trite trust law that the beneficiary of a discretionary trust does not have:
   
   a. an interest in trust property; or
   
   b. a contingent interest in the trust but only has a mere expectancy.16

3. Therefore, an interest in a discretionary trust is neither property owned by at least one spouse as required by subparagraph 84(1)(a)(i) nor something in which a spouse has a beneficial interest as required by subparagraph 84(1)(a)(ii).

4. Therefore, if an interest in a discretionary trust could not be family property in the first instance, then it cannot be excluded property as defined in section 1.

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16 This was aptly described in Foreman et al v. Kingstone et al ITELR 841 as follows:

   [41] The nature of the interests of the plaintiffs as beneficiaries under the trusts may be generally described as that of discretionary beneficiaries. They have or had, no interest in the trust property or trust funds of any of the trusts by reason of being named as discretionary beneficiaries or final sets of beneficiaries, except to the extent that the trustees may determine in the exercise of their discretion conferred by the relevant trust deed, that the plaintiffs or any of them shall be entitled to a distribution from the trust fund of any of the trusts.

   [42] The trustees have power to allocate capital and income to the discretionary beneficiaries, or any of them to the exclusion of the others. They do not need to do so. They cannot be required to do so. The discretion rests with them pursuant to the trust deeds. It is an absolute discretion.

   [43] A final beneficiary will receive an interest in the trust property or trust fund when it is finally distributed only to the extent that the trustees have not exercised their discretion to distribute the trust fund to the discretionary beneficiaries before or at the distribution date or vesting date.

   [44] Consequently the plaintiffs will be entitled to an interest in the trust fund only if and to the extent that the trustees exercise a power or discretion in their favour. They are merely objects of a discretionary power. Their interest is a mere expectancy.
Therefore, the result of applying a technical view that a beneficiary of a discretionary trust has no beneficial interest in trust property is that paragraph 85(1)(f) cannot apply to discretionary trusts because the interest is not one defined in 84(1).

Wide Interpretation: Avoid a Tautology

However, I think that there is little doubt that the narrow non-technical interpretation will not prevail because paragraph 85(1)(f) will be interpreted in a non-technical manner that does not render it a nullity based on basic rules of statutory interpretation. The analysis is as follows:

1. The ordinary meaning rule in statutory interpretation consists of the following three propositions:

   It is presumed that the ordinary meaning of a legislative text is the meaning intended by the legislature. In the absence of a reason to reject it, the ordinary meaning prevails.

   Even if the ordinary meaning is plain, courts must consider the purpose and scheme of the legislation; they must consider the entire context.

   In light of these considerations, the court may adopt an interpretation that modifies or departs from the ordinary meaning, provided the interpretation adopted is plausible and the reasons for adopting it are sufficient to justify the departure from the ordinary meaning.\(^\text{17}\)

2. More recently, the ordinary meaning rule has been described as the modern rule of statutory interpretation which is a unified interpretive approach in which courts find meaning for words that are harmonious with the legislation read as a whole:

   The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the [Income Tax] Act as a whole. . . . The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.\(^\text{18}\)

3. In determining the purpose behind paragraph 85(1)(f), a court would have recourse to both legislative history and other authoritative sources which would include the *White Paper on Family Relations Act Reform, Proposals for a New Family Law Act, July 2010* (the “White Paper”).

4. The White Paper states at page 81 that

   Proposed exclusions [i.e. excluded property] include: … trust property, unless the beneficiary spouse has an immediate and absolute interest in the trust property or has the power to terminate the trust.

5. Generally, when a word or expression has both an ordinary non-technical meaning and a technical meaning, the ordinary non-technical meaning is presumed.\(^\text{19}\) As it is presumed that


\(^{18}\) Trustco Mortgage Co. v. Canada, 2005 SCC 54

\(^{19}\) *Sullivan on the Construction of Statutes, Fifth Edition*, page 47.
the legislature wishes to be understood by the citizen, the law is deemed to have been drafted in accordance with the rules of language in common use.\textsuperscript{20}

6. If “property held in a discretionary trust” referred to in paragraph 85(1)(f) was “not property in which at least one spouse has a beneficial interest” as required by subparagraph 84(1)(a)(ii), then paragraph 85(1)(f) would have no meaning. Statutory interpretation includes a presumption against tautology. It is presumed that the legislature avoids meaningless words. Every word in a statute is presumed to make sense and to have a specific role in playing in advancing the legislative purpose.\textsuperscript{21} Stated another way:

\begin{quote}
A legislative provision must be construed so as to permit it to serve a useful purpose, if possible. A corollary of the rule of effectively favours the interpretation that best promotes the validity of the enactment, over one that invalidates it.\textsuperscript{22}
\end{quote}

7. The phrase "beneficial interest" is used in a common rather than technical fashion in other legislation. For instance, the ITA does this. For instance, "beneficiary" is defined in subsection 108(1) of the ITA as "beneficiary" under a trust includes a person beneficially interested therein. That term is clearly used in the ITA in respect of beneficiaries of discretionary trusts.

8. Further support for an ordinary non-technical approach can be found in 85(1)(f) itself which is consistent with a non-technical interpretation of beneficial interest because it refers to the property held by the trust.

9. In \textit{Williams v. R.}, [2005] 4 C.T.C. 2499 (T.C.C.), Woods T.C.J., specifically considered whether "beneficial ownership" had a narrow or broad meaning for the purposes of the ITA. Beginning at paragraph 32, Woods T.C.J. stated:

\begin{quote}
[32] The term "beneficial ownership" is not defined in the Act and, although much has been written about its meaning, there are surprisingly few judicial decisions that are of assistance. In accordance with well-known principles, the term "beneficial ownership" should be given its ordinary meaning consistent with the scheme of the Act (\textit{Bell Express Vu Limited Partnership v. Rex}, [2002] 2 S.C.R. 559).

[33] I would first observe that what is at issue is the meaning of "beneficial ownership" and not simply "ownership." The position of the Crown does not really extend the meaning of "beneficial ownership" beyond how courts have interpreted "ownership" for tax purposes and many of the Crown's arguments concern the meaning of "ownership." These arguments are not of much assistance because a different statutory term is at issue.

[34] It is for this reason that I do not find it helpful to look at general trust principles on the nature of a beneficiary's interest in trust property. According to the seminal authority on trusts, \textit{Donovan Waters}, there has been a long-standing debate in academic circles about whether a beneficiary can be said to have an ownership interest in trust property.\textsuperscript{[3]} One theory is that a beneficiary's only right is to require the trustees to perform their trust obligations. This so-called in personem right arguably does not give a beneficiary an ownership interest in trust property. In my view, whether this theory is correct or not is not relevant to the issue that I have to decide. What is at issue is "beneficial ownership," not "ownership."
\end{quote}

\textsuperscript{22} Pierre-André Côté, \textit{The Interpretation of Legislation in Canada}, p.369.
Although a different statute, this specifically addresses the argument that 85(1)(f) should not be interpreted in a narrow fashion albeit in the context of a different legislative regime. Woods T.C.J. did employ the modern rule of statutory interpretation in coming to this conclusion.\footnote{In 277287 Alberta Ltd. v. R., [1997] 3 C.T.C. 2380 Bell T.C.J., states at 2385 that “[b]eneficial ownership” connotes an interest in the property, capable of leading to the acquisition of legal title.}
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