USE OF TRUSTS IN BLENDED FAMILY ESTATE PLANNING*

Blended families are a reality in Canada. There are over one and a half million divorced people living in Canada, and each year, about seventy thousand marriages end in divorce. To this must be added the number of common law relationships that fail and the number of marriages that are effectively ended by separation rather than divorce. Many of these people will enter into subsequent relationships and thereby form blended families.

Blended families come in limitless varieties. Each blended family, and quite possibly each partner in a blended family relationship, has unique estate planning objectives. Probably the most common dilemma facing a blended family member is how to divide his or her wealth between the new spouse and the children from a previous relationship. Shaping this decision will be the individual's own values and beliefs, together with the circumstances that gave rise to the accumulation of their wealth. Also shaping this decision will be the constraints that are imposed by matrimonial property and dependants' relief legislation.

The role of an estate planning practitioner in a blended family situation is to help clients navigate the shoals of matrimonial property and dependants' relief legislation. The practitioner must therefore be conversant with these enactments. It also requires a deep understanding of the clients' circumstances and objectives.

This paper will discuss how trusts can be used to enhance estate planning structures to achieve both tax- and non-tax estate planning objectives for blended family clients, all the while being mindful of the unique legislative constraints under which blended family clients operate. By assessing various trust options against criteria of concern to blended family clients, the estate planning practitioner can produce a grid to illustrate for their clients the benefits and drawbacks of their various estate planning options.

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I. LEGISLATIVE CONSTRAINTS ON ESTATE PLANNING

Legislation constrains estate planning in two critical ways. First, legally married spouses have obligations under the ***Matrimonial Property Act***.[1] The Act can limit the estate planning options available to a married person if certain legislative preconditions are met. In circumstances where these preconditions are met, estate plans are subject to revision by the Court under the ***Matrimonial Property Act***. Second, all persons in long term relationships, including legal marriages and adult interdependent relationships[2], have obligations under the ***Dependants Relief Act***[3] and all estate plans are subject to revision by the Court under this Act as well.

Because orders made under the ***Matrimonial Property Act*** and the ***Dependants Relief Act*** are both enforced against property owned by the deceased spouse or partner at the time of death (ie. property that would fall into the deceased's estate), the size and composition of the deceased's estate is critical. To the extent that the deceased spouse or partner has reduced the size of his or her estate through *inter vivos* dispositions and will substitutes, these enactments offer little in the way of relief to the surviving spouse or partner. In these circumstances, the surviving spouse or partner may look to have the *inter vivos* dispositions voided under fraudulent preferences legislation. Surviving spouses whose marriages had broken down prior to the spouse's death may be able to have *inter vivos* dispositions set aside under the anti-avoidance provisions of the ***Matrimonial Property Act***. All others will have to seek relief under statutes of more

[1] R.S.A. 2000, c. M-8. Legislation varies from province to province. Readers should not assume that legislative provisions are the same fro province to province. See Ontario ***Family Law Act***, R.S.O. 1990, c. F-3; Saskatchewan ***Family Property Act***, S.S. 1997, c. F-6.3; Manitoba ***Family Property Act***, C.C.S.M. c. F25; New Brunswick, ***Marital Property Act***, S.N.B. 1980, c. M-1.1; Nova Scotia ***Matrimonial Property Act***, R.S.N.S. 1989, c. 275; Newfoundland ***Family Law Act***, R.S.N.L. 1990, c. F-2.

[2] As that term is used in the ***Adult Interdependent Relationships Act***, S.A. 2002 , c. A-4.5.

[3] R.S.A. 2000, c. D-10.5. Legislation varies from province to province. Readers should not assume that legislative provisions are the same fro province to province. See New Brunswick, ***Provision for Dependants Act***, S.N.B. 1991, c.62. s.3, Ontario ***Succession Law Reform Act***, R.S.O. 1990, c. S.26, Nova Scotia ***Testators' Family Maintenance Act***, R.S.N.S, 1989, c. 465; Prince Edward Island ***Dependants of a Deceased Person Act***, R.S.P.E.I., 1988, c. D-7, Newfoundland ***Family Relief Act***, R.S.N.L. 1990, c. F-3., Saskatchewan ***Dependants' Relief Act***, S.S.1996, c. D.25.01 , Manitoba ***Dependants Relief Act***, S.M. 1989-90, c. 42; British Columbia ***Wills Variation Ac***t, R.S.B.C. 1996, c. 490.

general application, such as the ***Fraudulent Preferences Act***[4] or the ***Statute of Elizabeth.***[5]

(a) *MATRIMONIAL PROPERTY ACT*

The ***Matrimonial Property Act*** is generally intended to ensure that spouses come away from a failed marriage with an equal share of the matrimonial property that was acquired during the marriage.[6] Certain properties are exempted from inclusion as matrimonial property,[7] and the Court has discretion to award unequal distribution if circumstances warrant it.[8] Generally, the Court will award an equal distribution of the non-exempt matrimonial property.

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4 R.S.A. 2000, c. F-24. Legislation varies from province to province. Readers should not assume that legislative provisions are the same fro province to province. Ontario ***Fraudulent Conveyances Act***, R.S.O. 1990, c. F.29; British Columbia, ***Fraudulent Conveyance Act***, R.S.B.C. 1996, c. 164; and ***Fraudulent Preference Act***, R.S.B.C. 1996, c. 164; Newfoundland ***Fraudulent Conveyances Act***, R.S.N.L. 1990, c. F-24; Saskatchewan ***Fraudulent Preference Act***, R.S.S. 1978; Manitoba, ***Fraudulent Conveyances Act***, C.C.S.M, c. F-160; Prince Edward Island ***Frauds on Creditors Act***, R.S.P.E.I. 1988, c. F-15.

5 ***Statute of Fraudulent Conveyances***, 1571 (U.K.), 13 Eliz., c. 5.

6 *7*(1) The Court may, in accordance with this section, make a distribution between the spouses of all the property owned by both spouses and by each of them.

. . .

(4) If the property being distributed is property acquired by a spouse during the marriage and is not property referred to in subsections (2) and (3), the Court shall distribute that property equally between the spouses unless it appears to the Court that it would not be just and equitable to do so, taking into consideration the matters in section 8.

7(2) If the property is

(a) property acquired by a spouse by gift from a third party,
(b) property acquired by a spouse by inheritance,
(c) property acquired by a spouse before the marriage,
(d) an award or settlement for damages in tort in favour of a spouse, unless the award or settlements compensation for a loss to both spouses, or
(e) the proceeds of an insurance policy that is not insurance in respect of property, unless the proceeds are compensation for a loss to both spouses,

the market value of that property at the time of marriage or on the date on which the property was acquired by the spouse, whichever is later, is exempted from a distribution under this section.

8 8 The matters to be taken into consideration in making a distribution under section 7 are the following:

(a) the contribution made by each spouse to the marriage and to the welfare of the family, including any contribution made as a homemaker or parent;
(b) the contribution, whether financial or in some other form, made by a spouse directly or indirectly to the acquisition, conservation, improvement, operation or management of a business, farm, enterprise or undertaking owned or operated by one or both spouses or by one or both spouses and any other person;
(c) the contribution, whether financial or in some other form, made directly or indirectly by or on behalf of a spouse to the acquisition, conservation or improvement of the property;
(d) the income, earning capacity, liabilities, obligations, property and other financial resources
 (i) that each spouse had at the time of marriage, and
 (ii) that each spouse has at the time of the trial;
(e) the duration of the marriage;
(f) whether the property was acquired when the spouses were living separate and apart;
(g) the terms of an oral or written agreement between the spouses;
(h) that a spouse has made
 (i) a substantial gift of property to a third party, or

The estate planning practitioner must keep two things in mind. First, the ***Matrimonial Property Act*** applies only to legally married spouses. The constitutionality of excluding common law spouses from matrimonial property legislation was upheld in ***Nova Scotia (Attorney General) v. Walsh***, [2002] 4 S.C.R. 325 (cited in ***Spracklin v. Kichton***, [2003] A.J. No. 1499 (Alta. Q.B.)). Unless the spouses are legally married, the surviving spouse has no claim under the ***Matrimonial Property Act***.

The second thing the estate planning practitioner must recognize is that the ***Matrimonial Property Act*** applies only in cases of marital breakdown. A surviving spouse can only claim under the ***Matrimonial Property Act*** if that spouse could have made the claim immediately before the spouse's death.[9] This requires marital breakdown. If the marriage has broken down and one of the spouses dies, the surviving spouse can commence or continue the ***Matrimonial Property Act*** claim. But not otherwise.

With these two factors in mind, the estate planning practitioner must consider the question, "What will happen to this estate plan in the event of a breakdown in the marriage?"

(ii) a transfer of property to a third party other than a bona fide purchaser for value;
(i) a previous distribution of property between the spouses by gift, agreement or matrimonial property order;
(j) a prior order made by a court;
(k) a tax liability that may be incurred by a spouse as a result of the transfer or sale of property;
(l) that a spouse has dissipated property to the detriment of the other spouse;
(m) any fact or circumstance that is relevant.

9 5(1) A matrimonial property order may only be made

(a) if
  (i) a judgment of divorce has been granted, or
  (ii) a declaration of nullity of marriage has been made
  with respect to the marriage,
(b) if one of the spouses has been granted a judgment of judicial separation,
(b.1) if one or both of the spouses have obtained a declaration of irreconcilability under the ***Family Law Act***,
(c) if the Court is satisfied that the spouses have been living separate and apart for a continuous period of at least one year immediately prior to the commencement of the application,
(d) if the Court is satisfied that the spouses are living separate and apart at the time the application is commenced and the defendant spouse
  (i) has transferred or intends to transfer substantial property to a third party who is not a bona fide purchaser for value, or
  (ii) has made or intends to make a substantial gift of property to a third party,
  with the intention of defeating a claim to property a spouse may have under this Part, or
(e) if the Court is satisfied that the spouses are living separate and apart and one spouse is dissipating property to the detriment of the other spouse.

Matrimonial Property Act awards take priority over the estate and are deemed never to have formed part of the estate.[10] To the extent the deceased spouse dies possessed of property (excluding jointly owned property that passes by right of survivorship to the surviving joint owner) all of that property is available to satisfy a posthumous matrimonial property award. Knowing this will be the case, the deceased spouse may have it in mind to dispossess himself or herself of property through *inter vivos* dispositions. If the deceased spouse does this with an intent to defeat a claim by the surviving spouse, such actions are, in essence, fraudulent conveyances. The surviving spouse may have recourse under the anti-avoidance provisions of the ***Matrimonial Property Act***, as well possibly, under the ***Fraudulent Preferences Act***, and the ***Statute of Elizabeth***. These methods of relief are discussed in more detail in the section that follows this paper's review of the ***Dependants Relief Act***.

Spouses are able to contract out of the ***Matrimonial Property Act***.[11]

Efforts by the deceased to reduce the amount of property that would otherwise be available to satisfy an award to a surviving spouse through *inter vivos* dispositions or will substitutes will not go unnoticed by the Court. In such cases, the Court has ordered unequal distributions of any property remaining in the hands of the deceased in order to satisfy a matrimonial property order. The estate planning practitioner should therefore be aware that efforts by a client to leave less than one-half of the matrimonial property to their surviving spouse through *inter vivos* dispositions and will substitutes can be thwarted, at least to the extent the client dies possessed of any property.

A client could effectively disinherit a surviving spouse in whole or in part through the use of will substitutes, but only if the client uses will substitutes to transfer his entire net worth at death.

By way of comparison, in other provinces, whether wealth is routed inside or outside of the estate can have a profound impact on the inclusion or exclusion of those assets in the accounting and can be manipulated to vary the spouse's share at death.

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[10] 15 Money paid to a living spouse or property transferred to a living spouse under a matrimonial property order is deemed never to have been part of the estate of the deceased spouse with respect to a claim against the estate.

[11] s. 37.

(b) *DEPENDANTS RELIEF ACT*

The ***Dependants Relief Act*** is generally intended to ensure that surviving dependants are afforded adequate provision for their proper maintenance and support out of the estate of the deceased.[12] Dependants are defined to mean the spouse or adult interdependent partner of the deceased, the minor children of the deceased, and children of the deceased who are unable by way of mental or physical disability to earn a living.

The estate practitioner should take careful note of the fact that relief is only available *out of the estate of the deceased*. Through the use of will substitutes, a person can effectively circumvent claims by dependants.

The estate practitioner must recognize that all estate plans involving dependants will be subject to the ***Dependants Relief Act***. The practitioner must therefore understand the scope of relief that can be afforded under this Act.

The legislation gives the Court broad discretion to determine an appropriate award.[13] This broad discretion was given more substance following the decision of the Supreme Court of Canada in ***Tataryn v. Tataryn Estate***, [1994] 7 W.W.R. 609 (S.C.C.) and the

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[12] 3(1) If a person

(a) dies testate without making in the person's will adequate provision for the proper maintenance and support of the person's dependants or any of them, or
(b) dies intestate and the share under the ***Intestate Succession Act*** of the intestate's dependants or of any of them in the estate is inadequate for their proper maintenance and support,

a judge, on application by or on behalf of the dependants or any of them, may in the judge's discretion, notwithstanding the provisions of the will or the ***Intestate Succession Act***, order that any provision that the judge considers adequate be made out of the estate of the deceased for the proper maintenance and support of the dependants or any of them.

[13] 3(2) The judge on the hearing of the application

(a) may inquire into and consider all matters that the judge considers should be fairly taken into account in deciding the application,
(b) may in addition to the evidence adduced by the parties appearing direct any other evidence to be given that the judge considers necessary or proper, and
(c) may accept any evidence that the judge considers proper of the deceased's reasons, so far as ascertainable,
   (i) for making the dispositions made by the deceased's will, or
   (ii) for not making adequate provision for a dependant,

including any statement in writing signed by the deceased.

various Alberta cases that have applied it. The principles of ***Tataryn*** were articulated the following way in ***Stang v. Stang Estate***, [1998] A.J. No. 261 (Alta. Q.B.):

> *[T]he words "proper maintenance and support" in s. 3(1) of the Act permit the court to determine what is **adequate** in light of the standard of living to which the spouse is entitled, and **proper** in the light of the obligations which the law would impose on the deceased in his life if the question of the claim were to arise. . . . In that sense, symmetry is established between the rights which might be asserted against the testator before death and those which might be asserted against his estate after death, due regard, however, being paid to the intentions of the testator.*
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> [Emphasis added]

In ***Moravec v. Moravec***, [1998] A.J. No. 392 (Alta. Q.B.), the Court clarified the legal obligations of a deceased spouse during his or her lifetime:

> *Where there is a claim by a surviving spouse against the Estate of the deceased spouse, I must determine the surviving spouse's entitlement first under the **Matrimonial Property Act**, as though the deceased spouse had not died.*

To many observers, the importation of ***Matrimonial Property Act*** principles into the ***Dependants Relief Act*** solved the major shortcoming of the former Act, namely, that it did not afford relief to spouses unless marital breakdown had occurred. With ***Matrimonial Property Act*** principles now applicable to ***Dependants Relief Act*** applications, so the observers said, nothing further needed to be done. The estate planning practitioner will note, however, that the Court's powers at s. 10(3) of the ***Matrimonial Property Act*** to set aside *inter vivos* dispositions have no counterpart in the ***Dependants Relief Act***. This is important because it narrows the relief available to married spouses not experiencing marital discord.

Like ***Matrimonial Property Act*** claims, ***Dependants Relief Act*** claims must be satisfied out of the estate of the deceased. This presumes the existence of an estate following the death of the deceased. In many cases, through a combination of *inter vivos* dispositions and will substitutes, the deceased's estate has little or no value. The client who wants to disinherit his dependant spouse can do so through the use of *inter vivos* dispositions and will substitutes. Under the ***Dependants Relief Act***, the surviving spouse has no ability to rebuild the estate through the avoidance of the *inter vivos* dispositions because those remedies exist only under the ***Matrimonial Property Act***. The Court has no jurisdiction under the ***Dependants Relief Act*** to affect such a remedy. As well, the Court has no jurisdiction under the Act to follow the proceeds of will substitutes into the hands of their recipients, and so cannot make those assets available to satisfy a dependant's award. The award must be satisfied out of the deceased's estate or not at all.

With these factors in mind, the estate planning practitioner must consider the question, "How could the ***Dependants Relief Act*** disrupt this planned distribution?"

It is contrary to public policy to contract out of the ***Dependants Relief Act*** and attempts to do so will not be enforced.[14]

(c) FRAUDULENT CONVEYANCE LEGISLATION

In seeking relief against a deceased spouse, a surviving spouse has recourse against any assets that were destined to fall into the deceased spouse's estate. If the deceased died possessed of an abundance of assets destined for his or her estate, then the surviving spouse, proceeding either by way of the ***Matrimonial Property Act*** (if a legally married spouse who qualifies to make a claim under that Act) or the ***Dependants Relief Act*** (which imports the essential principles of the ***Matrimonial Property Act***) can usually obtain relief.

A problem arises when all or substantially all of the wealth of the deceased spouse passes outside of his or her estate. As noted, a spouse can achieve this outcome by using a combination of *inter vivos* dispositions and will substitutes. This problem was recognized by the Alberta Law Reform Institute in ***Division of Matrimonial Property on Death – Final Report No. 83***, May 2000:

> *The term "will substitutes" describes assets that pass outside the estate and includes property held in joint tenancy, property that passes by way of beneficiary designation,* donatio mortis causa*,* inter vivos *trusts by which the settlor keeps the benefit and control of the assets until death, and life insurance. Several judicial decisions demonstrate that will substitutes are an effective means to deplete the estate and thereby diminish or defeat any claim that can be brought only against the estate.*

[14] The law on this point in Manitoba was summarized and clarified in *Davids v. Balbon* [2002] M.J. No. 244. In Alberta, see *Webb v. Webb Estate* [1995] A.J. No. 241 (Alta. Q.B.), and *Solomons v. Solomons* (2001), 38 E.T.R. (2d) 239.

The Alberta Law Reform Institute recommended changes to the ***Matrimonial Property Act*** that would make it more difficult to disinherit a spouse through the use of will substitutes:

> *To ensure that the division of matrimonial property on death cannot be easily circumvented, we recommend that for the purposes of calculating the entitlement of the surviving spouse, will substitutes that pass to third parties be treated as property of the deceased. . . . . If the estate is insufficient to satisfy the matrimonial property order, the surviving spouse would then be entitled to seek satisfaction of the deficiency from the recipients of the will substitutes.*

The Saskatchewan case, ***Harry v. Harry Estate****,* [1988] S.J. No. 189 (Sask. Q.B.) illustrates how effectively will substitutes can be used to disinherit a spouse. The deceased, a doctor, had been estranged and separated from his wife. She started divorce proceedings but he died before the proceedings could be completed. His will left everything to his children, cutting his wife out completely, and contained a separate insurance declaration directing all of his life insurance to his children, not to his wife. She claimed against his estate under Saskatchewan's ***Matrimonial Property Act***[15] and ***Dependants Relief Act.***[16] The matrimonial property claim failed because life insurance proceeds were excluded from the matrimonial property accounting under the Act. The Court reasoned that the policyholder owns the policy and may own the cash surrender value, but does ***not*** own the proceeds payable at death during the years leading up to it. There is no reason to expect that ***Harry*** would have been decided differently in Alberta.

In any case, no legislative action was taken in response to the Alberta Law Reform Institute's report, despite the restatement of its recommendations in its 2002 Report, ***Report on a Succession Consolidation Statute***. That being the case, in Alberta, *inter vivos* dispositions and will substitutes remain effective means of avoiding responsibilities toward a surviving spouse on death.

There remain at least two other means of drawing property back into the estate: the existing anti-avoidance provisions of the ***Matrimonial Property Act*** and the ***Statute of Elizabeth***, both of which have been used successfully in matrimonial cases. Each of these is discussed in turn.

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[15] S.S. 1979, c. M -61
[16] R.S.S. 1978, c. D-25

(i) ANTI-AVOIDANCE PROVISIONS OF THE *MATRIMONIAL PROPERTY ACT*

Those spouses who are entitled to bring a claim under the ***Matrimonial Property Act***, that is, those who suffered marital breakdown before death, may have some success in setting aside *inter vivos* transactions that deplete or diminish the estate. For the provisions to be operable there must have been either a transfer of property to a person who is not a bona fide purchaser for value or a substantial gift, made with the intention of defeating a claim, to a person who knew or ought to have known why the gift or transfer was being made, and the gift or transfer must have taken place no more than one year before the applicant spouse advanced his or her claim.[17] If all of these elements are satisfied, the Court can order the recipient to transfer the property to the surviving spouse. For cases of spouses successfully invoking section 10 of the ***Matrimonial Property Act*** to void *inter vivos* dispositions see ***Zacharuk v. Zacharuk*** [2004] A.J. No. 599, (Alta. Q.B.); ***Nay v. Nay*** [1981] A.J. No. 721(Alta. Q.B.); and ***Nay v. Nay Estate*** [1986] A.J. No. 353 (Alta. Q.B.).

(ii) *STATUTE OF ELIZABETH*

Both before and after the coming into effect of the ***Matrimonial Property Act*** (proclaimed in force on January 1, 1979), spouses have had *inter vivos* dispositions set aside under the ***Statute of Elizabeth***. One of the first cases where this occurred was ***Murdoch v. Murdoch*** [1976] A.J. No. 40 (Alta. S.C. T.D.). The wife in this case asked the Court to set aside conveyances the husband had made to his son. The Court summarized matters succinctly:

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[17] 10(1) When an application has been made for a matrimonial property order and the Court is satisfied that

(a) a spouse has
  (i) transferred property to a person who is not a bona fide purchaser for value, or
  (ii) made a substantial gift of property,
(b) the spouse making the transfer or gift did so with the intention of defeating a claim that the other spouse may have under this Part,
(c) the transferee or donee accepted the transfer or gift when the transferee or donee knew or ought to have known that the transfer or gift was made with the intention of defeating a claim a spouse may have under this Part, and
(d) the transfer or gift was made not more than one year before the date on which either spouse commenced the application for the matrimonial property order,

the Court may do any one or more of the things referred to in subsection (2).

> *The husband's reasons for these transfers can be found in his evidence on examination for discovery and on direct examination at trial. They are simple and direct. He wanted his son to have the land to operate a ranch eventually. He was afraid that his wife would get the land or that she had a percentage fee arrangement with her lawyers and they would get the land. Further, he had heard talk of change of the property laws that might prevent him from turning it over to his son. He thought he might lose the place and he needed it to run his cattle and his son's cattle. These are his stated reasons for transferring the property.*
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> *The intent of the husband is clear from this evidence. He wished to divest himself of the land so as to make it unavailable to satisfy any possible claim by the wife against him. On this basis the Court must determine whether the conveyances were fraudulent as being in contravention of Statute 13 Eliz., c. 5.*

The Court next determined the wife's standing under the statute:

> *With regard to the intent of the Statute, this is clearly set forth in the text, May on Fraudulent and Voluntary Conveyances (3rd Ed.), page 102:*
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>> *The Statute 13 Eliz. c. 5, is expressed to be to avoid conveyances & c., 'to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs.'*
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>> *The words 'creditors and others' are wide enough to include any person who has a legal or equitable right or claim against the grantor or settlor, by virtue of which he is, or may become entitled to rank as a creditor of the latter. The claim may arise out of a tort, as well as out of a contract, express or implied, or other legal obligation.*
>
> *While there is no evidence that the wife at the time of the transfers was a creditor within the provisions of the section, I am of the view that she can rightly be included in the category of "others" as set out in the section.*

Having determined the wife had standing, the Court next examined whether the necessary element of intent by the husband had been made out:

> *It remains to consider whether the conveyance was made to delay, hinder or defraud. On this aspect it is clear that the husband had the avowed intention of taking these lands out of his pool of assets in order that any claim of his wife could not be realized or secured against them. This portrays clearly his intent to hinder, delay or defraud his wife's claims and negatives any bona-fides in this conveyance between near relatives being father and son. . . . Having found for these reasons that this was not a bona-fide transaction and that it was in contravention of the provisions in Statute 13 Eliz., c. 5, I order that the conveyances be set aside and title to the lands be restored in the name of James Alexander Murdoch.*

The ***Statute of Elizabeth*** was invoked more recently by a plaintiff spouse in ***Proulx v. Proulx***, [2002] A.J. No. 163 (Alta. Q.B.). Before ordering the defendant spouse's conveyance of a condominium property into joint names with another set aside, the Court reviewed the principles applicable to the ***Statute of Elizabeth***:

> *It seems to me that the basic principles defining the remedy in 13 Elizabeth c. 5 are now well settled.*
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> 1. *There must be a conveyance of either real or personal property;*
> 2. *The transaction must have been for no or nominal consideration;*
> 3. *It must have been the intent of the settlor to defraud, hinder or delay his creditors;*
> 4. *The intent of the settlor may be inferred from his circumstances and the circumstances of the settlement or may be the result of direct evidence;*
> 5. *The fact that there was no consideration or voluntary consideration will in most cases justify the inference of the necessary intent absent evidence rebutting that inference;*
> 6. *Inference of intent will be strong if the settlor was insolvent at the time of settlement or the settlement effectively denuded him of assets sufficient to cover existing obligations;*
> 7. *The party challenging the conveyance must be a creditor or someone with a legal or equitable right to claim against the settlor;*
> 8. *The conveyance must have had the intended effect.*

Fraudulent conveyance legislation was used in ***Stone v. Stone*** (1999), 46 O.R. (3d) 31 (Ont. S.C.J.); (2001), 55 O.R (3d) 191 (Ont. C.A.) by a surviving spouse to set aside *inter vivos* dispositions made her spouse while he was suffering from terminal cancer. In anticipation of his death, and knowing that if he died possessed of his business holdings, his wife would have an equalization claim under Ontario's ***Family Law Act,***[18] the dying spouse made an *inter vivos* transfer of all of his business holdings to his children from a prior relationship. The Court found as fact that he did so with intent to defeat his wife's claim for equalization under the ***Family Law Act***. Following his death, the surviving spouse successfully attacked the disposition under Ontario's ***Fraudulent Conveyances Act***[19] and the Court ordered the *inter vivos* transfer set aside.

While the successful invocation of the ***Statute of Elizabeth*** in the Alberta cases of ***Murdoch***, ***Proulx*** and ***Zacharuk*** (where the Court noted in *obiter* that the ***Statute of Elizabeth*** also operated to provide relief to the plaintiff spouse) suggests *inter vivos* dispositions could be set aside, some questions remain about the scope of application to which the ***Statute of Elizabeth*** can be put. Citing Supreme Court of Canada authority from 1897,[20] the Court in ***Canada Life Assurance Co. v. 494708 Alberta Ltd.***, [1995] A.J. No. 752 (Alta. Q.B.) held the ***Statute of Elizabeth*** applied only where the transferor

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[18] R.S.O. 1990, c. F.3.
[19] R.S.O. 1990, c. F.29.
[20] *Mulcahy v. Archibald* (1897), 28 S.C.R. 523.

retains a benefit for himself. In ***Titan Investments Ltd. Partnership (Re)***, [2005] A.J. No. 1041 (Alta. Q.B.), the Court cited the same Supreme Court authority as well as other more recent authorities[21] to come to the same conclusion—that the transferor must retain a benefit for himself in order for the ***Statute of Elizabeth*** to apply. The Court distinguished ***Proulx***, noting that in the ***Proulx*** case the transferor did in fact retain a benefit to himself. *Quaere* whether ***Stone***, where the transferor effected an outright *inter vivos* disposition in anticipation of imminent death, would have been decided differently in Alberta due to the requirement for the transferor to retain a benefit.

II. UNDERSTANDING THE CLIENT'S CIRCUMSTANCES AND OBJECTIVES

It goes without saying that in order to prepare an appropriate estate plan for a client, the estate planning practitioner must have a deep understanding of the client's situation and estate planning objectives. Blended family clients present unique situations that will often impact on their objectives, and so the practitioner must be sure to use extra effort to ascertain these details.

(a) SIZE OF PROJECTED ESTATE

One of the first things that must be determined is the projected size of the client's estate. If the size of the estate is projected to be modest, then the practitioner should counsel simplicity in the estate plan. Common sense should play a role in discussions about estate structure if it is apparent that the cost to design and administer the estate plan is disproportionately large relative to the projected size of the estate. Most estate practitioners have witnessed at least one client who has gone to great lengths to describe how they want their estate distributed among a multitude of beneficiaries with each bequest being replete with contingencies and conditions, only to discover their client has little in the way of wealth to pass on. The practitioner should find out early on the projected size of the estate and should encourage the client to be realistic about their options when considering the available alternatives.

(b) CO-OPERATION BY SPOUSE

[21] *Glegg v. Bromley* (1912), 3 K.B. 474 (C.A.), cited with approval by the Alberta Supreme Court, Appellate Division in *Anderson Lumber Co. Ltd. v. Canadian Conifer Ltd.* (1977), 77 D.L.R. (3d) 126.

The Alberta Law Reform Institute discovered in its research that much of the time, clients in blended family situations are quite generous towards their current spouses. Often, the second spouse in a blended family situation will appreciate and accept their spouse's intentions to share his or her estate among the spouse and the children from a previous relationship. Spouses in blended families are often quite open with one another about their estate planning objectives, and if the client is prepared to accept the spouse's word that he or she will respect the other's estate planning intentions, then more sophisticated options need not be discussed. The practitioner will need to assess the degree of trust between his or her clients in order to determine whether the more sophisticated options need to be explored.

If the practitioner observes that a surviving spouse would be prepared to respect the estate planning intentions of the deceased spouse, the practitioner may want to probe the depth of that commitment. Will the spouse consent to measures intended to buttress the structure and protect it from attack? Will the spouse sign any form of acknowledgment or agreement?

(c) SIZE OF SHARE FOR CHILDREN

Assuming the client wants to leave something to the children of a previous relationship, the practitioner should determine the materiality of the intended bequest. How large is the share relative to the entire estate? How large is the share relative to the bequest to the surviving spouse. Would any of the children be entitled to bring their own application for dependants' relief?

(d) CLAIMS BY SPOUSE

The practitioner should make some attempt to assess the likelihood of the surviving spouse making a claim following the death of their partner. While recognizing that a surviving spouse will in most cases have the *potential* to bring a claim, realistically, what is the probability of the surviving spouse actually bringing a claim? Does the potential for a claim present a material risk to carrying out the client's intentions?

(e) DEGREE OF COMFORT FOR CHILDREN

This point is the flip side of the point that was just considered. That is, to what extent does the plan ensure the client's intentions towards the children will actually be carried out? If the likelihood of the surviving spouse bringing a claim is high, the likelihood of the plan being carried out in favour of the children is correspondingly lessened.

(f) ACCESS TO CAPITAL BY SURVIVING SPOUSE

If an estate plan incorporates one or more trusts, the question of encroachment arises. To what extent is the surviving spouse to have access to the capital? Is the trustee to have discretion over encroachment? Will the surviving spouse be trustee of his or her own trust? Will co-trustees be appointed?

(g) ACCESS TO CAPITAL BY CHILDREN

It may be the client's intent where trusts are built into the estate plan to permit his or her children to have access to the capital before the death of the surviving spouse. If that is the case, is the trustee to have full discretion on encroachment? Are there to be parameters as to the purposes for which encroachments may be made?

(h) TAX EFFICIENCY

Tax efficiency may take on a special concern in blended family situations where capital assets are intended for beneficiaries other than the surviving spouse. Family owned businesses, for example, may have considerable capital gains exposure, but may be intended for one or more of the children from a previous relationship. Sophisticated estate plans can use trusts to reduce the tax burden of the beneficiaries.

(i) COST AND CONVENIENCE

Few clients are unconcerned with what an estate plan will cost to design and administer. Not surprisingly, more sophisticated structures cost more, both in terms of costs to design and cost to administer. Costs may not be as fearsome as clients believe and in appropriate circumstances, the costs represent money well invested. In any event, the practitioner should ensure the client appreciates the costs involved with the selected structure.

III. USING TRUSTS AS ESTATE PLANNING TOOLS – AN OVERVIEW

The following table illustrates some the various types of trusts that the estate planning practitioner can use.

Trusts							
Testamentary Trusts				Inter Vivos Trusts			
Within the Estate		Outside of the Estate		No Rollover	Rollover – No Deemed Realization		
Qualifying Spousal Trusts	Family Trusts	Life Insurance Trusts	RRSP Trusts	Generic	Alter Ego	Joint Spousal	Spousal

Testamentary trusts, generally speaking, are trusts that come into existence upon the client's death. Testamentary trusts can either arise within the client's estate, and be funded with assets that would otherwise have fallen into the client's estate (ie. those assets which pass under the client's will), or they can arise outside of the estate and be funded by the client's non-estate assets (such as life insurance proceeds and RRSP proceeds). Testamentary trusts enjoy special treatment under the ***Income Tax Act*** and care must be taken to meet all of the necessary technical requirements for their establishment. Properly crafted, testamentary trusts can produce significant tax savings for surviving beneficiaries, in addition to helping the client achieve his or her non-tax estate planning objectives.

Inter vivos trusts are trusts established by the client during the client's lifetime. While *inter vivos* trusts do not enjoy the same tax treatment as testamentary trusts, they can play an important role in helping clients achieve their non-tax estate planning objectives, especially in blended family situations.

The estate planning practitioner can assess the desirability of incorporating one or more forms of trust into a client's estate plan by constructing the following grid, where each of the forms of trust is set against the estate planning criteria discussed above.

GRID ANALYSIS	Trusts							
	Testamentary Trusts				Inter Vivos Trusts			
	Within Estate		Outside of Estate		No Rollover	Rollover – No Deemed Realization		
Criteria	Qualifying Spousal Trust	Family Trusts	Life Insurance Trusts	RRSP Trusts	Generic	Alter Ego	Joint Spousal	Spousal
Size of Projected Estate								
Co-operation by Spouse								
Size of Share for Children								
Claims by Spouse								
Degree of Comfort for Children								
Access to Capital by Surviving Spouse								
Access to Capital by Children								
Tax Efficiency								
Cost & Convenience								

Using the above grid as a framework, this paper will discuss each of the types of trust shown above and will assess the feasibility of the form of trust in each situation.

(a) TESTAMENTARY TRUSTS

Some general comments should be made about testamentary trusts. A testamentary trust is one that is created by a person at their death and as a consequence thereof[22] and specifically includes trusts established under the terms of a persons will.[23] These testamentary trusts are said to arise "within the estate". Testamentary trusts can also arise "outside of the estate". Life insurance trusts, for example, being trusts funded with life insurance proceeds, arise outside of the estate and also qualify generally as testamentary trusts.[24]

Testamentary trusts provide tax advantages chief among which is taxation at graduated rates.[25] This characteristic can be used to great effect in income splitting strategies. Tax savings can be multiplied in structures under which the contents of the spouse trust "calf" at the death of the survivor, being divided into a series of successor testamentary trusts for the children ultimately to receive the wealth.[26]

For the high net worth client, testamentary trusts can provide material tax savings. A client should have at least $300,000 or $400,000 of available capital with which to fund a testamentary trust, as it is at this level that testamentary trusts begin to produce material tax savings. A testamentary trust funded with as little as $300,000 of capital can generate annual tax savings of $2,100 per year.[27] $500,000 of capital can generate annual tax savings of $3,500 per year. $750,000 of capital can generate annual tax savings of $5,250, even with a basic testamentary trust structure. A client who has an even higher net worth can derive even greater annual tax savings from more sophisticated testamentary trust structures.

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22 The specific definition for income tax purposes is found at subsection 108(1) ("testamentary trust") of the *Income Tax Act,* R.S.C. 1985, c.1 (5th supplement), referred to as the "ITA" in the balance of this paper.

23 ITA paragraph 248(9.1)(a).

24 M.N.R., Technical Interpretation 2000-0005135, "Trust - Property from Alter Ego Trust" (March 23, 2001); M.N.R., Technical Interpretation 2000-0059755, "Trust Receives Property from an Alter Ego Trust" (March 23, 2001); M.N.R. Technical Interpretation 9605575, "Testamentary Trust – Insurance Proceeds" (December 17, 1996); also see Barry S. Corbin, "Separate Insurance Trusts: Eating one's cake and having it too" (1992) 12 E. & T. J. 105.

25 ITA subsection 104(2).

26 M.N.R., Technical Interpretation 9801035, "Successive Trusts and Definition of Trust" (September 22, 1998).

27 Based on a federal-provincial marginal tax rates in place for Alberta and assumes 5% rate of investment return and surviving spouse paying taxes at the highest marginal rates.

(i) TESTAMENTARY TRUSTS WITHIN AN ESTATE

A testamentary trust, as noted above, can be established using estate assets, as would generally be the case with a trust established under a person's will, and can also be established outside of a person's estate, as would be the case with an insurance trust funded by life insurance directed under a beneficiary designation to the trustees of an insurance trust expressly established outside of the estate,[28] or a trust funded in similar fashion by proceeds from registered investments. Using the above framework as a guide, this section of the paper will discuss the two forms of testamentary trusts commonly established with estate assets within the estate of the deceased—qualifying spousal trusts and family trusts.

(A) QUALIFYING SPOUSAL TRUSTS

A qualifying spousal trust is a term of art under the ***Income Tax Act*** used, on a testamentary basis to describe a trust that meets the following requirements:[29]

- Created by the testator's will;
- Spouse or common law partner must be entitled to all of the income during the spouse's or common law partner's lifetime;
- No person other than the spouse or common law partner can have any entitlement to the capital of the trust during his or her lifetime;
- The assets must "vest indefeasibly" in the trust within 36 months of death;
- The testator must be resident in Canada immediately prior to death; and
- The trust must be tax resident in Canada.

Size of Projected Estate – No minimum amount is required to fund a qualifying spousal trust, although to generate tax savings of any substance, testamentary trusts generally require at least $300,000 of available capital, as outlined above. A qualifying spousal trust is often used as a means to delineate how wealth is to be shared between a surviving spouse and a client's children from a previous relationship. The residue of the client's estate is used to fund a qualifying spousal trust, the income from which is paid to the surviving spouse during his or her lifetime, and the remainder passes to the client's

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[28] For a general treatment of this type of trust see L. Frostiak and J. Poyser *Practitioner's Guide to Trusts, Estates and Trust Returns 2005-2006* (Toronto: Carswell, 2005), at pages 118 to 129.

[29] ITA subsection 70(6).

children following the death of the surviving spouse. There is a conceptual simplicity to the structure that clients often appreciate and desire, regardless of the size of their estates.

Co-operation by Spouse – Co-operation by the surviving spouse can be useful in buttressing the qualifying spousal trust arrangements. Where the spouses consent to such an arrangement on a mutual basis, they may choose to support the arrangement by entering "quit claim deeds" or other forms of releases, or an estate plan contract between them. The effect of those documents would be to give up any claim they might otherwise enjoy against each other's estates, at least to the extent permitted at law. While the document could be drafted as an outright release of all claims ("I hereby release all claims against the estate of my spouse, present or future, at law or equity, howsoever arising…"), the document is more commonly drafted as a conditional release, such as the following:

> *If my spouse dies with the attached will in place, or a substitute will to which I have consented in writing, I hereby release all claims against the estate of my spouse…*
>
> *or*
>
> *If my spouse dies with the attached will in place, or a substitute will that leaves me no less than $X outright and placing no less than $Y dollars in a spousal trust conforming to the terms set out below, I hereby release all claims against the estate of my spouse…..*

If both spouses are being represented by the same lawyer while quit claim deeds or estate plan contracts are being put in place, they should each have independent legal advice before the estate plan is executed. The lawyers giving that independent legal advice should have access not only to the wills and the agreement or quit claim deed, but also to comprehensive financial disclosure for both spouses. Independent legal advice can be undermined later if the lawyers and the parties do not have a clear indication as to what each party is potentially giving up.

Where the parties have declined to seek independent legal advice, that fact should be detailed in writing along with a clear indication, in plain language, that each partner has chosen to proceed at his or her own peril. It is not uncommon for spouses to decline the opportunity to seek independent legal advice under such circumstances. That introduces a weakness into the structure that should be explained in writing as well.

In a similar vein, couples will often choose to enter into mutual wills containing spousal trusts to protect capital for children from earlier relationships but choose to do so while declining to buttress the structures with any form of quit claim deed or estate plan agreement. That is their prerogative. This leaves the survivor under what often amounts to an "honour system" having a series of claims that might be made against the estate when the first spouse dies but living on in the context of a non-binding understanding that they will not bring those claims against the other's estate. Practitioners involved in such cases should document the file and advise the clients, in writing and before the documents are signed, to make the non-binding effect of the arrangements clear.

Before clients proceed without quit claim deeds or an estate plan agreement, or without legal advice for that matter, they should understand that the decision to attack or not attack the estate plan will not always be a decision that is up to the survivor. Where one spouse dies and the other is incapacitated, it is often the children of the incapacitated survivor who control that decision.[30] Whether they manage the parent's affairs under a power of attorney, or under guardianship or committeeship, they can bring a claim on behalf of the incapacitated parent against the stepmother's or stepfather's estate. Moreover, they may be obliged to do so if the statutory claims that might be brought afford the incapacitated survivor a larger share of wealth, or more accessible wealth in the form of cash, than will be available under the form of an income interest in a trust under the mutual wills. While clients are frequently comfortable to leave their spouses operating under the honour system, they are frequently uncomfortable when they realize the decisions may actually devolve to stepchildren or other decision makers. That possibility has to be addressed before the clients can make an informed decision as to independent legal advice or the necessity of buttressing documentation.

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[30] See *e.g. Scott (Guardian ad litem of) v. Scott Estate* (2005), 19 E.T.R (3d) 238. See also *Re Johnson* (2005), 19 E.T.R. (3d) 257 (being a failed effort to remove the stepchildren prosecuting the action for their incapacitated mother in *Scott (Guardian ad litem) v. Scott).*

As discussed later, a person cannot contract out of dependants' relief legislation, but the presence of an agreement will be a relevant factor in determining the extent of relief that is available.

Size of Share for Children – The qualifying spousal trust can only be funded by assets that stand in the name of the spouse at death, and then, only to the extent that the deceased spouse's asset base is not eroded by the surviving spouse's matrimonial property or dependant's relief claims. The following example illustrates the point:

Residence (owned jointly with new spouse)	*$300,000.00*
Registered investments with a designated beneficiary	*$500,000.00*
Non-registered investments	*$400,000.00*
TOTAL	*$1,200,000.00*

Out of the $1,200,000 of wealth that will pass as a result of this spouse's death, only $400,000 is available to fund the qualifying spousal trust. The residence will pass by rights of survivorship to the surviving spouse outside of the estate. The registered investments will pass outside of the estate directly to the surviving spouse if there is a beneficiary designation. Even if the dying spouse distributed the registered funds under his or her will, rather than by way of a beneficiary designation, the recipient of the registered funds must be the surviving spouse if the spousal rollover on the registered funds is to be preserved. If the registered funds were directed to any person (including a trust) other than the surviving spouse, the ***Income Tax Act*** would deem the funds to have been withdrawn by the deceased in his or her year of death, triggering immediate tax consequences. The surviving spouse would suffer a mammoth loss of tax deferral.[31] Practically speaking, therefore, only the non-registered funds are available to fund the spousal trust.

Claims by Spouse – The initial sections of this paper illustrate how the ***Matrimonial Property Act*** and the ***Dependants Relief Act*** can be used to strip assets out of an estate even before the spousal trust intended by the deceased spouse is settled.

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[31] In a lobbying initiative spearheaded by Phil Renaud, the Canadian Bar Association's Wills, Estates and Trusts (National Section) proposed to the Federal Government legislative amendments under which registered investments could be directed into a spousal trust without adverse tax consequences. The proposed changes were met with agreement in principle but specific language has not been developed and drafting issues have yet to be resolved.

Spousal trusts can only be funded out of estate assets that remain *after* any matrimonial property or dependants' relief claims have been heard. The surviving spouse or any one or more of the other trust beneficiaries may apply to Court to have the trust terms varied. For instance, the surviving spouse could apply to the Court to have the capital distributed immediately. Where there are competing classes of beneficiaries (as would be the case with a surviving spouse being an income beneficiary and the deceased spouse's children being remainder capital beneficiaries) the Court, on application by the beneficiaries, could order the values of the respective interests be quantified and paid out immediately.

Degree of Comfort for Children – To reiterate, trusts within the estate provide less comfort to children than trusts established outside of the estate. A qualifying spousal trust can provide a client with reasonable assurance that his or her children will ultimately inherit the trust capital. Being remainder beneficiaries, the children can require the trustee of the qualifying spousal trust to account from time to time. The Court's supervision can be invoked as needed. Trustees who are derelict in their duties or who fail to exercise an even hand among beneficiaries can be forced from office. This presumes, of course, the terms of the qualifying spousal trust have been crafted so as to endow the trustee with limited discretion, including limited powers of encroachment in favour of the surviving spouse. More on this point under the next heading.

Access to Capital by Surviving Spouse – The terms of a qualifying spousal trust can be crafted so as to allow the surviving spouse no access to the trust capital, to allow limited access to the capital, or to allow full access to the capital. The extent to which the surviving spouse can access trust capital is entirely up to the client and to the draftsperson.

Full access to capital by the surviving spouse may be desired, for example, where the qualifying spousal trust is being used strictly for tax planning purposes. In these instances, it is not unusual for the surviving spouse to be appointed as the trustee of his or her own spousal trust and given broad discretion to allow encroachment on the capital. To the extent that the client wishes to ensure benefits will ultimately accrue to the children, it is desirable to consider a more neutral third party to act as trustee, together with directions on how to exercise any capital encroachment power in favour of the surviving spouse.

Access to Capital by Children – The ***Income Tax Act*** bars anyone other than the surviving spouse from entitlement to either the income or capital of a qualifying spousal trust during the surviving spouse's lifetime. This prohibition effectively denies the children any access to capital of a qualifying spousal trust during the lifetime of the surviving step-parent. A provision that allows any access to capital in favour of the children, actual or potential,[32] taints the trust and triggers adverse tax consequences, including immediate taxation of capital gains on assets being inserted into the trust[33] and forcing the trust to realize capital gains every twenty-one years.[34] Where the step-parent and the children are relatively close in age, the use of a qualifying spousal trust could defer capital distributions to the children beyond their deaths. If capital were withheld until the death of the new spouse, the children might predecease. Where that is the case a combination of spousal and family trusts might employed.

Tax Efficiency – A qualifying spousal trust can be very tax efficient. It allows capital gains to be deferred until the death of the surviving spouse.[35] It is taxed as an individual[36] and is taxed at the graduated rates applicable to individuals.[37]

Properly crafted, a qualifying spousal trust can give rise to a number of family trusts (for example, one family trust for each of the deceased spouse's children) upon the death of the surviving spouse, each one of which will also qualify as a testamentary trust.[38] Done property, wealth would pass through the qualifying spousal trust and "calf" into a structure that multiplies tax savings when the wealth ultimately becomes available to the children.

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32 *Peardon v. Minister of National Revenue*, [1986] 1 C.T.C. 2083, 24 E.T.R. 88, 86 D.T.C. 1045, 1985 CarswellNat 486 (T.C.C.), at paragraph 13 ("There does not have to be any benefit obtained by any persons other than the spouse, the mere possibility is enough to say that the trust does not comply fully with the provisions requisite in the Act"). Also see *Albert M. Gilbert v. M.N.R.*, [1983] C.T.C. 2712, 83 D.T.C. 645, 1983 CarswellNat 335 (T.C.C.); and M.N.R., Technical Interpretation 2002-0126775, "Spousal Trust" (May 3, 2002).

33 ITA subparagraph 70(6)(b)(ii).

34 ITA subparagraph 104(4)(a)(iii) and paragraph 104(4)(b) and (c).

35 ITA subsection 70(6) and paragraph 104(4)(a).

36 ITA subsection 104(2).

37 ITA subsection 117(2).

38 M.N.R., Technical Interpretation 9801035, "Successive Trusts and Definition of Trust" (September 22, 1998).

Cost & Convenience – A qualifying spousal trust is a demanding document to draft, and more difficult still to draft well. The legal fees can quickly mount if drafted by a lawyer with specialized knowledge in tax and estate planning. The client should be prepared to bear some substantial up front design costs.

The qualifying spousal trust will also cost money to administer following the client's death. Accounting advice should be sought in the first tax year following death to secure the rollover on the terminal return and annually thereafter to prepare and file the trust income returns.

Trusts require one or more persons to act as trustee. Trustee fees can become a factor unless friends or family members agree to take on the responsibilities of trustee on a no-fee basis. Friends and family members of clients who are asked to serve as trustees should be aware that acting as trustee can be hazardous to friendships and to family relationships. Trustees are frequently in a position where they are asked to referee disputes between step-parents and children. This can make for awkward family gatherings in the future. So long as all parties are aware of the responsibilities they are taking on, the client is entitled to proceed in that fashion. The practitioner should document the file accordingly.

An alternative to friends and family members is to use a corporate trustee. Corporate trustees offer professional executor services and charge accordingly. Usually, fees are set out in advance by way of a fee agreement between the client and the corporate trustee. There are usually charges based on the amount under administration as well as annual amounts based on trust income and appreciation. Annual minimum fees may be applicable.

(B) FAMILY TRUSTS

Testamentary trusts funded with estate assets need not be constituted as qualifying spousal trusts. In this paper, such trusts are described as "family trusts" because beneficiaries of these sorts of trusts tend to be (but need not necessarily be) members of the deceased's family. Family trusts share many attributes with qualifying spousal trusts. Only passing reference will be made to attributes shared by both family trusts and qualifying spousal trusts. Other attributes are markedly different. This section of the paper will focus on the attributes that differ.

Size of Projected Estate – Family trusts can be funded with any amount of capital. No minimum amounts of capital are required. As was the case with qualifying spousal trusts, however, family trusts begin to general material tax savings when they are funded with capital amounts of between $300,000 and $400,000. Clients having substantial levels of net worth ($1,000,000 and over) would probably benefit from an estate planning structure that uses one or more family trusts as potential tax savings can be multiplied through the effective use of multiple testamentary trusts.

Cooperation by Spouse – The same considerations as for qualifying spousal trusts. Cooperation by the surviving spouse can be useful in buttressing the family trust arrangements.

Size of Share for Children – As noted above, family trusts can yield tax benefits if funded by at least $300,000 of capital. Family trusts therefore make sense where the size of the share intended for the children is of at least this magnitude, and even more so if the children are well-paid individuals in their own right.

Claims by Spouse – Family trusts are subject to claims by the surviving spouse in the same way that a qualifying spousal trust can be made subject to claims. Family trusts are generally settled out of assets forming part of the estate of the deceased. If the surviving spouse successfully asserts a claim to the assets in the estate, the family trust will have to be settled out of what if anything remains.

Degree of Comfort for Children – Like a qualifying spousal trust, a family trust can provide a client with reasonable assurance that his or her children will ultimately inherit the trust capital. The children have the same abilities to require the trustee to account from time to time and they can invoke the Court's supervision as needed. The level of comfort enjoyed by the children will depend entirely, of course, on what discretionary powers have been granted to the trustee to encroach upon the trust capital for the surviving spouse.

Access to Capital by Surviving Spouse – The terms of a family trust can allow as much or as little access to the capital by the surviving spouse as the testator desires. If a family trust is being used strictly for income tax reasons, the testator may appoint the surviving spouse as the trustee of the family trust, with unlimited discretion to encroach upon the capital during the lifetime of the surviving spouse. Where the client wants to allow the surviving spouse some access, but wants assurances that some of the capital will remain for the children, appropriate limitations on discretion will need to be included.

Access to Capital by Children - Unlike a qualifying spousal trust, anyone can be named as a beneficiary of a family trust without attracting adverse tax consequences. The terms of the trust can permit payment of both the income and the capital to any of the trust beneficiaries, at whatever times desired by the testator. As an example, a trust might be established in a spouse's will on terms making all income payable to the surviving spouse but also providing for an interim capital distribution of one-half of the trust property to the prior children when the surviving spouse attains age 65, to dove-tail with a pension entitlement the survivor might enjoy, or an interim distribution of one-half just prior to the twenty-first anniversary of the trust's establishment. This type of structure would bear consideration where the step-parent, as the survivor and income beneficiary, might be expected to survive some or all of the stepchildren – a possibility that presents in the hackneyed "trophy wife" or "trophy husband" situation. The goal is to support the second spouse while ensuring that the children are still able to inherit while they are young enough to benefit from it.

Tax Efficiency – Family trusts can also be very tax efficient, but with one very important limitation: the spousal rollover cannot be applied to assets that are used to fund a family trust. Depending on the nature of the deceased spouse's assets, this can attract significant capital gains and recapture in the year of death. In some circumstances, clients are prepared to bear the tax consequences. The tax cost may be acceptable if weighed in context against other options and considerations. Where clients are prepared to proceed on this basis, the practitioner should ensure those ramifications have been clearly explained to them and appropriately documented on the file.

Where the tax consequences are viewed as too punitive, a structure might be employed which provides for a pair of trusts, the first, a qualifying spouse trust and the second, a family trust, giving the executor the ability after the client's death to slot assets into either of the two trusts and thereby manage the extent to which capital gains and recapture are to be suffered.[39]

Departing from the use of a qualifying spouse trust in favour of a family trust also means that the twenty-one year deemed disposition rule under section 104(4)(a) applies. Capital gains taxes and recapture will be payable every twenty-one years so long as the assets remain in the trust. Provisions that allow capital to be rolled out to the children prior to the twenty-first anniversary of the family trust can be used to sidestep the deemed disposition if the disposition would lead to adverse tax consequences.[40]

Cost & Convenience – Costs of designing and implementing a family trust structure are of similar magnitude to those involved with qualifying spousal trusts. Design costs will be somewhat higher as extra drafting is involved and extra time will usually be required to familiarize the clients with the structure's features. Annual administration costs after death will usually be a straight multiple of the costs associated with qualifying spousal trusts as each family trust will be required to file a separate trust income return.

(ii) TESTAMENTARY TRUSTS OUTSIDE OF ESTATE

Testamentary trusts can be established outside of a client's estate in the form of an insurance trust or, possibly, an "RRSP trust." Such trusts will qualify as testamentary, and garner the income splitting advantages inherent in testamentary trusts provided that no assets are settled into the trust during the client's lifetime (the trust cannot be settled with "a dollar" or a gold coin), the payment of proceeds under the life insurance designation or the beneficiary designation has to result from the death of the client, the client has to be the personal owner of the life insurance contract or registered investments, the client must enter an insurance designation, if life insurance or a beneficiary designation, if registered investments, that directs the proceeds at their death

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39 For examples and CRA commentary on these structures see M.N.R., Interpretation Bulletin IT – 305R4, "Testamentary Spouse Trust" (October 30, 1996), at paragraph 7, and see M.N.R., Technical Interpretation 5-8832, "Testamentary Spouse Trust" (April 2, 1990)("answer number 2").

40 ITA subsection 107(2). For additional commentary see Wolfe D Goodman, "Deemed Realizations on the 21st Anniversary of a Trust" (paper presented to the CBA (Ontario) September 12, 2000, as part program "Tax, Trusts and Estates: When Worlds Collide"); Rosanne T. Rocchi, "Estate Planning and Litigation: Recent Developments of Importance" (Canadian Legal Lexpert Directory, LEXD/2001-25).

to the trustees of the trust, not their "estate," or "heirs," or "next of kin," and the designation document must qualify under provincial law as a testamentary instrument.[41]

A document qualifies as a testamentary instrument if no consideration passes, it has no immediate effect, it is revocable and the position of the client and the trustees and beneficiaries does not immediately change.[42] The general view and the better view appears to be that a life insurance designation is a testamentary instrument, securing tax treatment as testamentary, but one that can be validly executed without following the requirements of wills legislation that, across Canada, imposes stringent requirements as to witnesses and other technical requirements. Those requirements are sidestepped as life insurance beneficiary designations, and designations of registered investments, are governed by specific provincial legislation outside of wills legislation. In Alberta, life insurance declarations are governed by section 574 of the ***Insurance Act***[43] and RRSPs are governed by the section 47 of the ***Trustee Act***.[44]

(A) LIFE INSURANCE TRUSTS

A life insurance trust can be described in general terms as follows:

> *An insurance trust is typically funded with the proceeds of a life insurance policy paid out on the death of the settler. An insurance trust funded with proceeds can be testamentary or inter vivos. Generally, the favorable tax treatment received by a testamentary trust means that most insurance trusts funded with life insurance proceeds are set up as testamentary unless there is some compelling reason not to do so. Testamentary insurance trusts are generally used when a trust is warranted or required but the settler wishes, at the same time, to achieve probate avoidance, maintain confidentiality or anticipates problems with creditors and wishes to keep the proceeds of the policy free from claims while held in trust. The particular value of an insurance trust funded with proceeds of a life insurance policy flows from the special characteristics attaching to life insurance: first, protected status as creditor-proof in the context of most claims by creditors in most, if not all, jurisdictions across Canada; and, second, the ability to direct the payment of proceeds by way of a beneficiary designation that can be used to circumvent the estate and, thereby, maintain confidentiality and avoid the*

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41 See *e.g.*, M.N.R., Advance Ruling 2004-0060201R3, "First Nation Ruling" (January 1, 2004). As to RRSP trusts see M.N.R., Technical Interpretation 2002-0143685, "RRSP/RRIF and Testamentary Trusts" (January 29, 2003). For a general discussion of insurance trusts see Larry H. Frostiak and John E.S. Poyser, *Practitioner's Guide to Trusts, Estates and Trust Returns 2005-2006* (Toronto: Carswell, 2005), at pages 118 to 129.

42 *Elliot v. Turner*, [1944] O.W.N. 185., [1944 2 D.L.R. 313, 1944 CarswellOnt 120 (M.C.). More generally, see *MacInnes v. MacInnes* (1934, [1935] S.C.R. 200, 2 I.L.R. 14, [1935 1 D.L.R. 401, 1934 CarswellOnt 139 (S.C.C.) (which supports the conclusion that a designation of life insurance is a testamentary instrument – the conclusion would be different given an *irrevocable* designation).

43 R.S.A. 2000 c. I-3.

44 R.S.A. 2000 c. T-8.

> *payment of probate fees or other estate taxes levied by provincial and territorial governments.*[45]

The life insurance declaration should identify the insurance policy or policies in specific terms, referring to the policy number where possible.[46]

The terms of an insurance trust can be set out in the will (but should clearly and expressly stipulate that the insurance trust is not part of the estate or the estate property) or can be set out in a separate insurance declaration or trust agreement. If the trust is to qualify as spousal and avoid the deemed realization at twenty-one years by qualifying under paragraph 104(4)(a) of the ***Income Tax Act*** then it is critical that the terms of the trust are detailed in the will itself. The ***Income Tax Act*** imposes this as an express requirement for a qualifying spouse trust both for the purposes of rollovers, under subsection 70(6), and for the purpose of avoiding the twenty-one year deemed dispositions, normally confronting trusts, under subsection 104(4).

When establishing an insurance trust under terms set out in a will, it is not uncommon to employ a brief clause that simply refers to and repeats by reference the other terms of the will creating trusts within the estate. This creates a pair of parallel trusts, one within the estate and one outside of the estate. For illustrations, refer to the will drafting used in ***Re Goldstein*** (1984), 31 Alta. L.R. (2d) 80;[47] ***Re Sanderson***, [1934] O.W.N. 46 (Ont. H.C.J.);[48] ***Vance v. Peppiatt*** (1973), 42 D.L.R. (3d) 161 (Ont. C.A.);[49] ***MacInnes v. MacInnes***, [1935] S.C.R. 200;[50] and ***Denyer Estate v. Denyer,*** [1998] A.J. No. 1416 (Alta. Surr. Ct.)[51]

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45 Larry H. Frostiak and John E.S. Poyser, *Practitioner's Guide to Trusts, Estates and Trust Returns 2005-2006* (Toronto: Carswell, 2005), at pages 119-120.

46 *Denyer Estate v. Denyer*, [1998] A.J. No. 1416 (Alta. Surr. Ct).

47 I WILL AND DECLARE that all insurance on my life and owned by me which may be payable to my wife in accordance with the terms thereof shall be held by my Trustees in trust for my wife and children upon the like trusts, terms and conditions and administered in the like manner as I in this will have directed with respect to the remaining property of my estate

48 I WILL AND DECLARE that all insurance on my life no matter to whom made payable, with the exception of Policy Number 2005169 in Sun Life Insurance Company, which is payable to Mrs. Pauline Marcileta Holmes, shall be payable and paid to my trustees, and the proceeds shall be held by my trustees in trust for my wife and my issue upon the same trusts terms and conditions as are hereinafter declared regarding the residue of my estate

49 I WILL AND DECLARE that all insurance proceeds on my life shall be payable and paid to my Trustees and the proceeds shall be held by my Trustees upon the same trusts, terms and conditions as if such proceeds had founded a part of the residue of my Estate

50 I WILL AND DECLARE that all insurance policies on my life, shall be payable and paid to Chartered Trust and Executor Company in trust for the use and benefit of my said wife and my mother upon the same trusts, terms and conditions as if the said proceeds had formed part of the residue of my estate.

51 Proceeds from my Life Insurance Policies are to be transferred, outside of Probate, to be used to set up a trust fund, at a location & in terms as set up by the executors. The trust is to be used in the following manner. . .

Each of the above examples purports to govern all policies on the deceased's life in a generic manner (eg. "all insurance on my life"). As indicated earlier, that language should be approached cautiously as it may not be effective as a valid insurance declaration in all circumstances.

The terms of an insurance trust can be made to mirror the terms of a qualifying spousal trust or a (testamentary) family trust funded from estate assets. Therefore, an insurance trust compares no differently from other testamentary trusts against many of the criteria set out above: size of projected estate, size of share for children, access to capital by surviving spouse, access to capital by children, tax efficiency, and cost and convenience. An insurance trust differs greatly from other testamentary trusts, however, against other criteria: co-operation by spouse, claims by spouse, and degree of comfort for children. These distinctions are discussed here.

Co-operation by Spouse – For the reasons that follow, co-operation by the surviving spouse is somewhat irrelevant. Spouses will have difficultly under current legislation asserting claims to life insurance benefits paid into a life insurance trust. To the extent the client wants to obtain additional comfort from the surviving spouse, quit claims or releases could be secured from the surviving spouse at the time the policies are acquired, assuming of course the surviving spouse is prepared to cooperate.

Claims by Spouse – Because a life insurance trust is funded with assets from outside of the estate of the deceased, the trust is much more insulated from claims by a surviving spouse than either of the types of trusts that could be established within an estate (qualifying spousal trusts or family trust). A life insurance policy that has its proceeds directed into a trust (rather than directed to a named beneficiary) is an effective form of will substitute, albeit a will substitute with a more sophisticated structure. The structure can be crafted so as to direct some or all of the income or capital to the surviving spouse if desired by the dying spouse, or it can be crafted so as to exclude the surviving spouse from any participation at all. Neither the ***Matrimonial Property Act*** nor the ***Dependants Relief Act*** affords a remedy against life insurance proceeds, and it is difficult to see how, if at all, either the ***Fraudulent Preferences Act*** or the ***Statute of Elizabeth*** would operate to void the acquisition of the insurance policy.

In jurisdictions where dependants' relief claims are confined to estate assets,[52] an insurance trust becomes a useful vehicle for providing for beneficiaries free from competing claims that might otherwise be brought by a client's dependants. There is no provision in Alberta's ***Dependants Relief Act*** to permit a surviving dependant recourse against life insurance proceeds, as these are beyond the scope of the estate. This planning does not work in Ontario or other jurisdictions featuring anti-avoidance provisions allowing dependants to pursue assets like insurance proceeds outside of the estate.

All of the above might be taken to presuppose that a client has a large insurance policy. A more interesting constellation of issues arises where the client has an extensive collection of investments and cashes them in to buy a life insurance policy or other life insurance product (such as a life insured annuity or a segregated fund) with a large cash pay-out at death. In essence, the client who does this is employing a will substitute to transmit wealth at his or her death outside of the estate. For reasons discussed above, this would appear to be an effective means of wealth transmissions. It is doubtful that such a technique could be challenged under fraudulent preference legislation as it appears there would have been valuable consideration received by the transferor, namely, the life insurance policy or other life insurance product that was purchased.

Degree of Comfort for Children – For the reasons stated in the immediately preceding paragraph, this form of trust ranks among the best structures to give comfort to children that they will enjoy the proceeds that are intended for them. It presumes the client is in a position to acquire life insurance (ie. they have not become uninsurable for health or other reasons). Whether the client informs their spouse of their intentions and actions in this regard is up to the client.

[52] Alberta, Manitoba, British Columbia, Saskatchewan are examples. Jurisdictions that have anti-avoidance provisions include Prince Edward Island, the Northwest Territories, Nunavut, and the Yukon Territory.

(B) RRSP Trusts

An RRSP trust is one funded by proceeds of a registered plan, whether an RRSP or a RRIF, established as a testamentary trust apart from a client's estate in a manner analogous to an insurance trust. The trust will be subject to creditors to the same extent that the registered investments transferred outside of the estate are subject to creditors. Whether such investments are subject to the claims of creditors remains a bit of an open question and depends on the jurisdiction. In Ontario, registered investments that have passed to a designated beneficiary are *not* subject to creditors as a result of the decision in Amherst Crane Rentals Ltd. v. Perring (2002), 46 E.T.R. (2d) 1, var'd 11 E.T.R. (3d) 112 (Ont. C.A.), leave to appeal to the Supreme Court of Canada refused, 247 D.L.R. (4^{th}) vii. In other jurisdictions, owing to differences in legislation, registered investments may or may not be subject to attack by creditors.

A RRSP trust does not, under current rules, allow for income tax deferral (as discussed earlier), and except in the case of a disabled child, will exact an income tax penalty when used in a spousal context, that penalty flowing from the loss of deferral.

As indicated earlier, such trusts appear to qualify as testamentary when established properly, and could qualify as spousal if the terms of the RRSP are set out in the will document.

A RRSP trust will only be indicated in those circumstances where a client has an extensive portfolio of RRSPs, has a shortened life expectancy, and is willing to sacrifice tax deferral. The life expectancy issue flows from the requirement that registered investments be converted into RRIF's and withdrawn on a scheduled basis from the plan. This creates a dwindling and time limited investment pool. As a result of those limitations it is submitted that RRSP trusts will be employed rarely. Some practitioners establish a blended insurance/RRSP trust to receive both proceeds of life insurance and proceeds of registered investments.

(b) INTER VIVOS TRUSTS

Inter vivos trusts can also be used in blended family and second marriage situations. In general terms, *inter vivos* trusts provide poorer tax positioning but, like life insurance trusts, better defensive positioning against unco-operative spouses claiming against the estate after the death of the first spouse.

An *inter vivos* trust is defined for the purposes of trust law and common legal parlance as one that is established by a living person as settlor. For the purposes of the *Income Tax Act* (Canada), however, an *inter vivos* trust is defined as any personal trust that does not qualify as testamentary,[53] and therefore includes testamentary trusts that have lost that status through mismanagement.[54]

There are advantages and disadvantages in employing *inter vivos* trusts.

Size of Estate – The complexity and degree of administrative burden involved with *inter vivos* trusts tends to limit their use to households where there is fairly significant wealth. There may be circumstances where these strategies are examined for families with a few hundred thousand dollars in wealth at issue. More commonly, these structures are considered where the wealth in hand exceeds the $1,000,000.00 or $2,000,000.00 range. As an exception to that, these structures may be considered with lesser amounts involved if the planning process is incidental to a corporate freeze strategy to deal with future capital gains exposure on corporate shares. There are, however, no minimum amounts needed to fund an *inter vivos* trust. In that case, blended family issues are addressed in passing.

Co-operation by Spouse – Where both spouses are co-operating, the pair of them may settle one trust to hold all of their combined assets, or a pair of trusts having the same effect. That might be the case where each of them has children from an earlier relationship and agree on the manner in which their combined wealth is to be distributed. They could place assets in a trust structure allowing them access to income and discretionary access to capital while the two of them were alive and had capacity but, upon the death or incapacity of either of them, lock the capital in the structure until the second of their deaths. If the structure is consensual, then independent legal advice would be advisable for both.

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53 ITA subsection 108(1).

54 The list of potentially disqualifying events is canvassed in L. Frostiak and J. Poyser, *Practitioner's Guide to Trusts, Estates and Trust Returns, 2005 – 2006* (Toronto: Carswell, 2005), at pages 38-39).

While both spouses remain capable, the trust could be flexible, allowing for capital encroachments, or amendment, or wind-up. Only after one of the two spouses was no longer able to actively participate in the structure would the capital be locked down in the structure. After the capital is locked in, however, it would be beyond the power of the spouses to redirect it. This avoids many of the pitfalls that afflict estate planning based on formal promises.

The spouses would retain their ability to revise their wills, but their wills would no longer govern the wealth in the trust. The survivor might remarry after the death of the first, but the capital in the trust is not under their legal ownership – it is legally owned by the trustees of the trust. Moreover, if the surviving spouse remarries then pre-acquired property and trust benefits enjoy non-sharable status in at least some jurisdictions in Canada[55] on the subsequent breakup of that later relationship. In addition to remarriage protection, the spouse who remains alive and capable cannot squander the capital, or give it away. This type of planning is sometimes pursued as a form of incapacity planning.

A trust company can be substituted as the trustee of the structure after one of the spouses is incapacitated.

As another scenario, one spouse may choose to settle a substantial collection of his or her assets into an *inter vivos* trust while the other does not, but with the concurrence of the other nonetheless. A well-heeled partner may settle an *inter vivos joint* spousal trust, naming the children of the well-heeled partner as capital remainder beneficiaries. Both spouses would be income beneficiaries. On the death of the first, the second would continue as an income beneficiary. If it improves the income position of the spouse beneficiary, then he or she might be expected to concur, even if it provides a conduit of guaranteed capital towards the children. It gives the spouse the assurance of an income stream they might not otherwise expect to receive. To the extent that the surviving spouse concurred in the estate planning arrangements during the lifetime of the well-heeled partner, that becomes a relevant factor in the Court's later determination whether to award an unequal distribution of any assets that pass through the well-heeled spouse's estate.

[55] Manitoba and Ontario, as examples.

Where one spouse is acting unilaterally, without the co-operation of the other, *inter vivos* trusts can still be used in much the same way in Alberta. As discussed elsewhere in this paper, surviving spouses will encounter an uphill battle to set aside any *inter vivos* dispositions.

Size of Share for Children – An *inter vivos* trust structure typically allows for larger portions of wealth to be set aside and routed to the children as the ultimate destination of the assets. A client can lock in a substantial proportion of his or her assets in this way, and ensure that his or her children ultimately receive the capital. Properly crafted, the surviving spouse will find it difficult to change the structure. There are virtually no limitations on the type of assets that can be held in the trust, with the exception of funds having registered status. If registered funds are to be inserted into the trust, they would first have to be deregistered prior to insertion and applicable taxes would need to be paid.

Claims by Spouse – As noted above, where one of the spouses dies, the survivor's avenues of attack on the trust property held in an *inter vivos* trust outside of the estate are limited. The ***Matrimonial Property Act*** is largely ineffective to prevent the use of *inter vivos* trusts. It does not apply unless a triggering event has occurred, and even where applicable, it has limited application to reach out to assets that pass outside of the estate, as discussed above. Because orders under the ***Dependants Relief Act*** must be made out of the estate of the deceased, assets settled on *inter vivos* trusts by the deceased are effectively beyond the reach of a dependant claiming under this Act. The surviving spouse may have some recourse under the ***Fraudulent Preferences Act*** of the ***Statute of Elizabeth*** to set aside the inter vivos dispositions. This also has been discussed above.

Degree of Comfort for Children – An *inter vivos* trust provides significant comfort for the children who ultimately stand to inherit the property. The assets are transferred into the trust and out of harm's way during the parent's life. The child or children can be trustees of the trust. As capital beneficiaries, they have the immediate right to an accounting for the assets. They may also challenge conduct on the part of the trustees who waste or prejudice their remainder interests.

Access to Capital by Surviving Spouse – The surviving spouse can be given access to capital to whatever extent the trust document allows. An immediate division or formal promise will provide a more liberal access to capital in general terms than will trusts, whether *inter vivos* or testamentary.

Access to Capital by Children – An *inter vivos* trust can permit as much or as little access to capital by the children as the client desires. A trust can be established to include both the spouse and the children as capital beneficiaries during the life of the spouse. Such a trust, however, would not qualify as a spouse trust, or as a joint spousal or joint common-law partner trust. Capital settled on such a trust will trigger a disposition in the hands of the contributor and the trust will be subject to a deemed realization of all trust assets every twenty-one years while the assets remain in the trust.

If it is expected that the children will require access to capital during the surviving spouse's lifetime, it might be better for the client to consider a combined strategy, whereby children are given a first tranche of capital by way of an immediate division and a second tranche by way of a joint spousal trust.

Tax Efficiency – *Inter vivos* trusts are taxed at top rates on every dollar of income left in the trust. In many circumstances this is moot as all of the income will be attributed by to the contributor and taxed on the contributor's tax return under subsection 75(2) of the *Income Tax Act* (Canada) if the contributor retains any right or possible opportunity to receive the return of capital or discretionary control of its future destination.[56] The contributor must be willing to foreswear access to the capital to avoid attribution. If the trust is not one that attracts 75(2) attribution, any income paid to the beneficiary is generally taxed in the hands of the beneficiary[57] unless the trustees choose to designate the income as trust income and have it taxed in the trust.[58] Income left in the trust, however, will be subject to top rate tax unless the beneficiary is disabled and the

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56 See generally M.N.R., Interpretation Bulletin IT-369R, "Attribution of Trust Income to Settlor" (March 12, 1990); and Larry H. Frostiak and John E.S. Poyser *Practitioner's Guide to Trusts, Estates and Trust Returns 2005-2006* (Carswell: Toronto, 2005) at pp. 239-248.

57 ITA Subsection 104(24).

58 ITA Subsections 104(13.1) and (13.2). Since the trust is taxed at top rates, this is rarely done unless the beneficiaries live in a province other than Alberta where top rate taxes are higher and the beneficiaries are in the 3rd or 4th tax bracket.

preferred beneficiary election is available.[59] Where attribution occurs under 75(2) the ongoing trust is normally tax neutral during the life of the settlor.

Settling assets on the trust will, however, be a disposition and trigger capital gains, capital losses and recapture. As exceptions to that general rule, assets can be transferred *inter vivos* into a qualifying spouse trust,[60] alter ego trust,[61] joint spousal trust or joint common-law partner trust[62] without triggering capital gains, recapture, or losses on settlement. Moreover, those forms of trusts are exempt from the deemed realization of trust assets that otherwise occurs every twenty-one years on trust assets.[63] Each of those forms of trusts is described at greater length below.

Inter vivos trusts can usually be used to avoid probate fees. This may be of use to clients who own real property outside of Alberta in a high-probate jurisdiction such as Ontario, British Columbia or Nova Scotia, or plans to move to one of those jurisdictions later in life.

As a downside to the use of an *inter vivos* trust, an *inter vivos* trust cannot be used to fund a testamentary trust at the death of the lifetime beneficiary.[64] This forbids access to the collection of attractive income splitting strategies discussed earlier in this paper that are available through the use of testamentary trusts. Families focused on securing the best possible income tax positioning tend to favour the use of testamentary trusts in this context. Those hoping to put the largest possible pool of assets outside of their estates and free from potential dependents relief claims tend to favour *inter vivos* trusts.

Cost and Convenience – Lawyers have historically charged higher fees for establishing an *inter vivos* trust than a testamentary trust. An *inter vivos* trust also carries with it the immediate need to file annual trust returns for income tax purposes.[65] Annual costs to

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59 ITA subsections 104(12) and (14).
60 ITA subparagraph 73(1.01)(c)(i).
61 ITA clause 104(4)(a)(iv)(A).
62 ITA clauses 104(4)(a)(iv)(B) and (C).
63 ITA clause 104(4).
64 M.N.R., Technical Interpretation 9818696, "*Inter Vivos* Vs. Testamentary Trusts" (August 7, 1998); M.N.R., Technical Interpretation 9901635, "Status of Successive Trusts" (February 16, 1999); M.N.R., Technical Interpretation 2000-0059755, *supra*, note 13; M.N.R., Technical Interpretation 2001-0097285 "Status of Successive Trusts" (November 2, 2001).
65 A tax return being required by CRA for the trust even where all of the income has been attributed to the contributor under ITA subsection 75(2). CRA is not always consistent on this point, and it has been the subject of debate by commentators in the estate planning literature.

administer an *inter vivos* trust will be comparable to the costs to administer a testamentary trust.

(i) *INTER VIVOS* SPOUSAL TRUSTS

Inter vivos spousal trusts are rarely used in blended family planning, unlike their testamentary cousins. Once assets are settled into the trust, they cannot be retrieved, at least during the lifetime of the spouse beneficiary, and the prospect of marital or relationship breakdown make such trusts awkward. Clients are loath to settle a trust that will entitle their spouse to continuing life-time income even if the relationship ends.

A trust qualifies as an *inter vivos* spousal trust where each of the requirements listed below are met:[66]

- The transferor has to be resident in Canada at the time of the transfer;
- The transferor cannot be a trust;
- The trust must be created by the transferor;
- The transferor's spouse or common-law partner must be "entitled" to receive all of the income of the trust during his or her lifetime; and
- No one other than the spouse or common law partner can have the use of the capital or receive any part of the capital during the lifetime of the spouse or common law partner.

As noted earlier, assets can be settled on an *inter vivos* spouse trust on a rollover basis,[67] and the deemed realization that would otherwise occur at twenty-one years is deferred until the death of the spouse beneficiary.[68]

(ii) ALTER EGO AND JOINT PARTNER TRUSTS

The following requirements must be present to qualify a trust as a joint spousal or common-law partner trust:[69]

- The trust must be created after 1999 and be an *inter vivos* trust;[70]
- Under the terms of the trust, the taxpayer or taxpayer's spouse or common-law partner must be in combination with the spouse or

66 ITA subsection 73(1.01).
67 ITA section 73.
68 ITA subparagraph 104(4)(a)(iii).
69 ITA subparagraph 104(4)(a)(ii.1)
70 ITA subparagraph 104(4)(a)(ii.1).

common-law partner or the taxpayer entitled to receive all of the income of the trust that arose before the later of the death of the taxpayer and the death of the spouse or common-law partner and no person can, before the later of those deaths, receive or otherwise obtain the use of any of the income or capital of the trust;[71] and

- The person creating the trust must have attained the age of sixty-five years at the time the trust was created.[72]

One spouse or common-law partner can contribute all of the property to the trust or both spouses or common-law partners can contribute property jointly to the same trust and still qualify for treatment as a joint spousal or common-law partner trust.[73]

A joint spousal trust is established where the partners are legally married. A common-law partner trust is established where a couple meets the qualifying definition in the *Income Tax Act*, including same- and opposite-sex couples who have cohabited together in a conjugal relationship for a period of time of at least one year.

As an example, a client might wish to place all of her investments into a joint spousal trust, with the client and her husband as discretionary income beneficiaries. The contributor spouse during her lifetime might also be a capital beneficiary. The trustees might be the contributor spouse at first instance, and perhaps her children or a trust company if the contributor spouse were to die or become incapacitated. Terms could be drafted removing her spouse as an income beneficiary if the marriage were to dissolve or the couple were to separate. Her children would have the comfort of seeing the wealth sequestered immediately and beyond the reach of their stepfather. They would not have to worry about his potential remarriage or bankruptcy. On the death of their mother, the stepfather would be entitled to income for life. Unless he could allege a fraudulent conveyance or other imperfection when the trust was settled, the assets in the trust would appear to be immune from claims in Alberta under matrimonial property or dependants' relief legislation.

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71 ITA subclauses 104(4)(a)(iv)(B) and (C).
72 ITA subparagraph 104(4)(a)(iv).
73 M.N.R. Technical Interpretation 2001-0099055, "Joint Spousal Trust" (January 23, 2002).

An alter ego trust is akin to a joint spousal or common-law partner trust with one major difference. Only the contributor can access or have the use of capital, and the contributor must be entitled to all of the income. The non-contributing spouse cannot be entitled to income or capital. On the death of the contributing spouse, the terms of the trust can be flexible. The capital might be held and the income used for the surviving spouse. The capital might, instead, be directed immediately to the children. In the latter case, the alter ego trust essentially acts as a will substitute to make an immediate division outside of the estate.

An alter ego trust could be employed in putting a collection of assets outside of the estate of the mother but, at her death, directing those assets directly to her children and denying her husband both income and capital at her death.

An alter ego trust is able to opt out of the rollover that takes place on the settlement of the trust, but that is not the case for a joint spousal or joint common-law partner trust.[74]

(iii) OFFSHORE *INTER VIVOS* TRUSTS

It is possible to establish a trust offshore in a jurisdiction that will not honour foreign judgments, or makes claims against assets difficult to bring by virtue of restrictive limitation periods.

Some clients, typically rich clients, establish offshore trusts for asset protection purposes.[75] The laws of Alberta are among the most permissive in Canada in allowing for blended family estate planning, and a combination of testamentary trusts outside of the estate and *inter vivos* trusts will normally be successful in directing assets to the children. In those cases where the clients might move to other jurisdictions, like Ontario, with extensive anti-avoidance measures in place, or where attacks are anticipated under fraudulent conveyance legislation, the clients might wish to consider an offshore trust.

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74 ITA subparagraph 104(4)(a)(ii.1).

75 For a detailed exposition of offshore trusts for protection, see Kelly R. Doyle, “Asset Protection” (Markham: Butterworths, 2005) at 211 – 254.

From an income tax perspective, these trusts are generally tax neutral. They carry with them fairly heavy set up and trustee costs, as well as reporting requirements. They are, nonetheless, in use.