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TAB 2

THE ANNOTATED

Alter Ego Trust and Discretionary Trust

2017

The Annotated Discretionary Trust 2017

(Updated from 2015)

M. Elena Hoffstein, ***Fasken Martineau DuMoulin LLP***

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cpd Continuing Professional Development

The Annotated Alter Ego Trust
and Discretionary Trust
<@>, 2017

The Annotated Discretionary Trust

By

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Fasken Martineau DuMoulin LLP

This handout and the corresponding presentation are for general information purposes only. They do not constitute a legal opinion or other legal advice and the memorandum of trust is not to be used without reference to the tax and other issues that may impact in particular facts. Readers are advised to obtain advice before making a decision or taking other action regarding a specific matter.

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** Many thanks to Joan Jung of Minden Gross for her helpful additions and suggestions to the Annotated Trust and in particular to the discussions relating to Associated Corporations, Phantom Income, and the Role of the Protector.

ANNOTATED DEED OF SETTLEMENT

made this <*> day of <*>, <*>

THE <*> FAMILY TRUST

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ANNOTATED DISCRETIONARY TRUST

***Annotation**: A person may wish to transfer assets to a trust fur a number of tax and non-tax reasons. Tax reasons include the desire (a) to transfer the tax burden from a high bracket taxpayer to a taxpayer in a lower tax bracket; (b) to utilise the enhanced capital gains exemption of various members of the family; (c) to access the lower tax rates of a different province (such as Alberta at this time); and (d) prior to amendments to subsection 122(1) of the Act[1] in the case of testamentary trusts, to multiply the ability to access the lower tax rates by using multiple testamentary trusts. As a result of such amendments, including the introduction of the term, "graduated rate estate" for 2016 and subsequent taxation years, it will no longer be possible to multiple access to the marginal rates.*

Non-tax reasons include the following: (a) to set a mechanism in place to manage one's property in the event of disability or incapacity; (b) to protect property from the claims of creditors; (c) to provide for disabled beneficiaries without jeopardising their government benefits; (d) to provide for a person who is not able to look after his or her property by reason of minority, mental incapacity or lack of business experience; (e) to give a beneficiary the benefits of property ownership without giving up control over the property; (f) to provide for successive interests; and (g) to avoid the application of provincial probate taxes.

As a general rule, a transfer of property to a trust constitutes a disposition for income tax purposes. Paragraph 69(1)(b) will generally deem the proceeds of "disposition" to be the fair market value of the property transferred whether the disposition is by way of inter vivos gift, or by way of transfer for no proceeds or for proceeds less than fair market value.

The definition of "disposition" is contained in subsection 248(1) of the Act. Over time, the definition of disposition for tax purposes has been expanded. It is important to review these provisions when considering any disposition which affects the transfer of assets to trusts, the transfer of assets by trusts, dealing with trust assets by a trust and dealing with the interests of the beneficiaries.

Exceptions to the deemed fair market value disposition on the transfer of assets to a trust include transfers to a spousal trust both inter vivos and testamentary and transfers to the following types of trust: bare trust; alter ego trust; and joint spousal or common law partner trust.

The following discussion will focus on certain tax and non-tax factors to keep in mind when drafting a discretionary inter vivos trust.

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1 All references to "the Act" will be to the *Income Tax Act* (Canada) R.S.C. 1985 c. I-5 as amended.

THIS DEED OF SETTLEMENT made in duplicate as of the <*> day of <*>, 2017

B E T W E N:

<*>, of the City of <*>, in the Province of <*>,

(hereinafter called the "**Settlor**")

OF THE FIRST PART

– and –

<Trustee #1>, of the City of <*>, in the Province of <*>, <Trustee #2>, of the City of <*>, in the Province of <*>, and <Trustee #3>, of the City of <*>, in the Province of <*>,

(hereinafter called the "**Trustees**")

OF THE SECOND PART

SETTLOR

Annotation*: It is necessary to be aware of the various attribution rules contained in the Act when establishing and administering an inter vivos trust as these rules will impact on (1) the decision of who should be the Settlor, and who should be the Trustees, (2) will affect the powers of the Settlor and Trustees, (3) will influence the selection of the income and capital beneficiaries, (4) will influence the scope of their respective interests, and (5) will affect the manner in which the trust will be funded. The attribution rules include the corporate attribution rule in subsection 74.4 of the Act as well as the personal attribution rules contained in subsections 74.2 and 74.3 of the Act, the hidden traps of the special attribution rule found in subsection 75(2) and its companion subsection 107(4.1), the deemed interest rule contained in subsection 56(4.1) of the Act and subsection 56(2).

Attribution Rules

Subsection 74.3(1) of the Act provides that where an individual has transferred or loaned property to a trust in which another individual who is at any time a "designated person" in respect of the individual, is beneficially interested at any time, then any income or loss from the property (or property substituted therefor) or (in the case of a designated person who is a spouse or common-law partner of the transferor or lender) any capital gains realised from a disposition of the property (or property substituted therefor) which would be included in computing the income of the beneficiary, as a result of a distribution from the trust to the beneficiary, is attributed to the individual who has transferred or loaned the property to the trust. This also applies to property substituted for the original property (248(5)).

"Designated person" in respect of an individual means the individual's spouse or common-law partner, his or her minor nieces and nephews, and any minor (under 18 years of age) who does not deal at arm's length with the individual.

Another attribution rule, subsection 56(4.1), may apply, if an individual loans property to a trust and a beneficiary of the trust is an individual who is 18 years of age or older who does not deal at arm's length with the lender if it may reasonably be considered that one of the main reasons for the making of the loan was to reduce or avoid tax by causing the income from the loaned property (or from property substituted for such loaned property or from property that the loan enabled or assisted the trust to acquire) to be included in the income of the beneficiary. In such a case any income from the loaned property (or from property substituted for such loaned property or from property that the loan enabled or assisted the trust to acquire) that would otherwise be included in the income of the beneficiary will be attributed to the lender.

Exceptions

The attribution rules will not apply to income from business or income on income (sometimes referred to as second generation income) and will not apply to fair market transfers or fair market value loans. With respect to fair market loans this means (1) interest was charged on the loan at the lesser of the rate that would have been agreed on between arm's length parties or at the prescribed rate in effect at the time of the loan, and (2) the interest accrued each year was paid not later than 30 days after the end of each year in which the loan remains outstanding (subsection 74.5(2) of the Act).

Guarantees

Subsection 74.5(7) of the Act is a further attribution rule which provides that if an individual guarantees repayment of a loan made by a third party to a "specified person" with respect to an individual, as that term is defined in the Act, the loan by the third party is deemed to have been made by the individual. For these purposes, a specified person with respect to an individual is a "designated person", as defined above. It is for this reason that any loan made by an arm's length person to a trust should not be guaranteed by any individual in respect of whom a beneficiary is a specified person to the guarantor.

Avoiding the Attribution Rules

If one wishes to avoid the attribution rules, the trust should not receive property by transfer or loan from a person in respect of whom the beneficiaries are designated persons nor should the Settlor or any other person in respect of whom any of the beneficiaries are designated persons guarantee any loans from arm's length third parties. (Also see discussion below re: subsection 75(2), as it may impact on the identity of the Settlor and his/her ability to be a Trustee or a beneficiary.) However, in most cases, certain of the beneficiaries will include designated persons in respect of the Settlor or person who transfers property to the Trust. Thus, it is important (i) that the settled amount consist of an asset such as a coin, which will not generate income or capital; (ii) that the settled amount not be liquidated or used to subscribe for income producing assets such as common shares on an estate freeze; and *(iii) that any funds used to acquire property that will produce income or capital gains be acquired with funds borrowed from a third party (financial institution) and that the borrowing is not guaranteed by any person in respect of whom any beneficiary is a designated person.*

Preferred Beneficiary Election

The concept of the preferred beneficiary election (PBE) was introduced in the 1971 tax reform legislation which brought in capital gains taxation. Prior to tax reform, income of a trust could only be taxed in the hands of a beneficiary if it was paid or payable to that beneficiary in a taxation year. Tax reform legislation added the concept that income which was the subject of election by preferred beneficiaries would also be deductible.

The preferred beneficiary election is a mechanism which allows the accumulating income of a trust to be taxed in the hands of the beneficiaries without the income being distributed to the beneficiary. The use of the preferred beneficiary election has the advantage of being able to have the income taxed in the hands of beneficiaries who are generally in lower tax brackets, while permitting the trustees to retain control over the income. Additional flexibility is achieved as the tax paid income which remains in the trust is added to capital and, in the case of a discretionary trust, can be distributed among capital beneficiaries not necessarily those who participate in the election.

The February, 1995 Budget severely restricted the use of the election and it is now only available to trusts with a preferred beneficiary who suffers from disability sufficient to qualify for the tax credit under subsection 118.3(1)). A preferred beneficiary as defined in subsection 108(1), must be an individual resident in Canada who is a beneficiary and who is the Settlor, the spouse or former spouse of the Settlor, a child, grandchild or great grandchild of the Settlor or a spouse of any such person. With respect to residence in Canada, the preferred beneficiary must be resident in Canada at the end of the taxation year. If there are beneficiaries who qualify for the so-called disability tax credit under subsection 118.3(1),and it is desired to have the preferred beneficiary election available, then in determining the identity of the Settlor, attention must be paid to his/her relationship to the beneficiaries.

TRUSTEES

<u>Annotation</u>: The factors to consider in selecting the Trustees include the residence of the Trustees and the attribution rules found in subsections 75(2) and 107(4.1).

(a) Residence of a Trust

The Act does not provide any rules for determining the residence of a trust for tax purposes. The residence of a trust or an estate is a question of fact. For years the case of Thibodeau Family Trust v. The Queen[2] ("Thibodeau") was cited as the judicial authority for the residence of a trust being determined by the residence of a majority of the trustees. The court in Thibodeau apparently rejected the central management and control test for determining

[2] 78 DTC 6376 (Federal Court Trial Division).

residence of trusts when it stated the following in response to argument analogizing to the principles for determining corporate residence (at paragraph 22):

> ***"The judicial formula for this respecting a corporation, in my view, cannot apply to trustees because trustees cannot delegate any of their authority to co-trustees. A trustee cannot adopt a "policy of masterly inactivity" as commented upon in Underhill on the Law of Trusts and Trustees, 12th Edition, page 284; and on the evidence, none of the trustees did adopt such a policy. Therefore, it is not possible for a trust to have a dual residence for income tax purposes, and therefore it is not possible to find that part of the paramount of "superior and directing authority" of a Trust is and was in two places. In any event, a finding of dual residence of this Trust is not made in this case."***

The question of the residence of a trust was considered in the case of Garron Family Trust v. Her Majesty the Queen ("Garron").[3]

At issue was the residence of two trusts created during the reorganization of a Canadian resident corporation whereby the common shares of a Canadian resident corporation were converted into preference shares and common shares were issued to two new Canadian holding companies. The common shares of these holding companies were then issued to two trusts settled by a resident of St. Vincent Islands. The sole trustee was a regulated trust company resident in Barbados. Each trust had a protector resident in St. Vincent who could remove and replace the trustee at any time, provided that the protector could be replaced by a majority of the beneficiaries who were Canadian residents. When the trusts disposed of the majority of their shares in the holding companies there were realized capital gains of over $450,000,000.00.

Amounts were withheld and remitted to the CRA pursuant to section 116 of the ITA and the trusts sought a return of the amounts on the basis of an exemption from Canadian tax liability under Article XIV(4) the Canada-Barbados Tax Treaty. Pursuant to the treaty, subject to certain exceptions, capital gains may only be taxed in the jurisdiction in which the taxpayer is resident. Reassessments of the trusts were issued on the basis that the treaty exemption did not apply.

The Minister of National Revenue argued that the trusts were resident in Canada under the central management and control test, that the Barbados trustee was "compliant" and that the actual management and control resided with persons in Canada. The Appellants argued that the trust was not resident in Canada under the Thibodeau test of residency and that the central management and control test was not applicable.

Justice Woods of the Tax Court of Canada ruled that the correct test to be applied in determining the residence of a trust for Canadian income tax purposes was where central management and control actually abides. Adoption of this test to the question of trust

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3 2009 DTC 1297 (TCC), affirmed 2010 FCA 309 (FCA), affirmed 2012 SCC 14 (SCC).

residence promotes consistency and fairness. Justice Woods limited Thibodeau's rejection of the management and control test to its particular facts and to its assumption that the management and control of a trust must reside with the trustee because the trustee has a fiduciary obligation to manage and control the trust. According to the Garron decision, this assumption is inappropriate because it assumes that trustees always comply with their fiduciary obligations.

In a trust context, management and control of a trust resides with the person who makes the "key decisions" for the trust. Justice Woods found that the management and control of the trusts resided with the Canadian beneficiaries and not the Bermuda trustee because:

(a) The trustee was selected to provide administrative services.

(b) There was no evidence to suggest the trustee was expected to have decision making responsibility.

(c) The evidence suggested the trustee had limited role.

(d) The limited role of the trustee was enforceable through protector provisions – i.e., the protector could replace the trustee and the Canadian beneficiaries could replace the protector.

Justice Woods concluded that had the Trusts not been resident in Canada by reason of the central management and control test, but deemed resident pursuant to s.94 of the Act, this deeming would not result in the trusts being "resident" for treaty purposes. Justice Woods also concluded that the transactions did not constitute an abuse or misuse of the Treaty and the GAAR did not apply.

Both the Federal Court of Appeal and the Supreme Court of Canada endorsed the application of the central management and control test in determining the residence of a trust. The following is an excerpt from the Supreme Court of Canada judgement (at paragraph 15):

> ***"As with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where "its real business is carried on" (De Beers, at p. 458), which is where the central management and control of the trust actually takes place. As indicated, the Tax Court judge found as a fact that the main beneficiaries exercised the central management and control of the trusts in Canada. She found that St. Michael had only a limited role — to provide administrative services — and little or no responsibility beyond that (paras. 189-90). Therefore, on this test, the trusts must be found to be resident in Canada. This is not to say that the residence of a trust can never be the residence of the trustee. The residence of the trustee will also be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident. These, however, were not the facts in this case."***

Garron indicates that the residence of trustees will no longer automatically determine the residence of a trust. Evidence of management and control of a trust will be necessary in order to determine residency on a going forward basis. Proper documentation of decision making and activities of trustee will become increasingly more important.

It would also be important that the Settlor of the trust or a person other than the Trustees does not control the decisions of the Trustees nor exercise dominion over the trust assets. The same is true with respect to the trust beneficiaries. The Trustees should not be seen to be the agents of the beneficiaries. No one should have veto powers or a power of appointment over the assets if it is important to establish the residence of a trust in a particular jurisdiction.

There have a number of recent provincial tax cases where the issue was the province of residence of a trust.[4] The principles from Garron were applied in fact based exercises to determine who in fact exercised management and control. In The Herman Grad 2000 Family Trust, the Ontario Superior Court of Justice distinguished between what were referred to as "administrative actions" (such as the calculation and payment of income tax; payment of professional fees; and execution of annual resolutions of the trust) versus control income and distribution decisions and oversight of the investment of the particular trust's property.

It should be noted that a trust's residence may change if a trustee is replaced or a trustee changes his or her personal residence status, assuming that such trustee carries out the central management and control of the trust. . A change of the trust's residence status for Canadian tax purposes could cause a deemed disposition of trust property.

Reference should also be made to Income Tax Folio S6-F1-C1, "Residence of a Trust or Estate" (September 19, 2014).

(b) Subsection 75(2) Attribution

An important attribution rule which requires consideration in the context of the selection of the Settlor and the Trustees is the rule in subsection 75(2) of the Act. Subsection 75(2) is an attribution rule which applies in circumstances where a person exercises a certain measure of control over the property transferred to a trust or retains a certain type of interest.

Subsection 75(2) will apply where property of a trust is held on any of the following conditions: (i) that the property may revert to the person from whom the property was received; or (ii) pass to persons to be determined by such person at a time subsequent to the creation of the trust; or (iii) that, during the existence of such person, the property shall not be disposed of except with the consent of that person.

[4] See Discovery Trust v. MNR, 2015 CarswellNfld 212 (Nfld and Labrador SC (TD)); Boettger v. Agence du revenue dur Quebec, 2015 QCCQ 7517; The Herman Grad 2000 Family Trust v. Minister of Revenue, 2016 ONSC 2402 (Ont. SC)..

If subsection 75(2) applies, there is both an attribution consequence and a negative effect upon the ability to "roll-out" property of the trust (which may be relevant prior to the 21st anniversary of settlement or upon trust wind-up). This is further discussed below.

Previously CRA took the position that subsection 75(2) applies even if property is transferred to the trust at fair market value by a person who is a capital beneficiary on the basis that it does not seem to matter how the property comes into the trust (even if the transferor may have received consideration equal to the fair market value of the property so transferred) but rather whether the terms of the trust are such that the person who transferred the property to the trust may re-acquire it or property substituted therefor. This contrasts with other attribution rules which are deemed not to apply to fair market value transactions.[5]

However, in the case of Her Majesty the Queen v Sommerer,[6] the Federal Court of Appeal held that subsection 75(2) does not apply to a beneficiary who transfers property to a trust at fair market value.

The facts briefly stated are as follows: In 1996, the father of the taxpayer-appellant established an Austrian Foundation and endowed it with 1,000,000 Austrian shillings. The settlor retained the right to revoke the Foundation and amend the deed with the consent of the advisory committee. The beneficiaries included the taxpayer, his wife and children provided they were also resident in Austria. Because the taxpayer and his wife were Canadian residents they were only potential beneficiaries until they became resident in Austria. They were also the ultimate beneficiaries in a provision that did not stipulate country of residence and as such were entitled to receive the property of the Foundation on its dissolution or revocation.

On the date following the creation of the Foundation, the taxpayer sold all of his common shares of Vienna Systems Corporation ("Vienna") to the Foundation at their fair market value. Part of the purchase price was paid for from the funds endowed by the Settlor and the balance was to be paid at a later date (with interest). In 1998 the taxpayer sold his shares in another corporation (Cambrian) to the Foundation at fair market value. In December 1999 the Foundation sold some of the Vienna Shares to three arms'-length individuals and realized a capital gain and in December 1998 the Foundation sold the balance of the Vienna shares to Nokia Corporation and also sold the Cambrian shares to Nortel, in both cases realizing a capital gain.

At trial, the Tax Court determined that the Foundation was a trust and that subsection 75(2) does not apply to property purchased by a transfer from a beneficiary at fair market value and thus there was no attribution on the capital gains realized by the Foundation on the sale of the various shares held by it.

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5 74.5(1), 74.1(1), (2) and 74.(2), and see CRA Document Number 9332575 (January 27, 1994); CRA Document Number 2001-0114045 (July 11, 2002); CRA Document Number 2004-0086941C6 (October 8, 2004); CRA Document Number 9601665 (August 26, 1996); CRA Document Number 9411115 (April 28, 1994); CRA Document Number 9203385 (June 26, 1992); CRA Document Number 2002-0118255 (June 10, 2002); CRA Document Number 2000-0012557 (July 17, 2000); CRA Document Number 2002-012676A (February 7, 2003).

6 2012 F.C.A. 207 (FCA).

The Federal Court of Appeal upheld the Tax Court decision that subsection 75(2) does not apply to a genuine sale of property by a beneficiary to a trust. This is a welcome limitation to the broad application of subsection 75(2) by CRA.[7] CRA has since indicated that it accepts the foregoing but with emphasis on a "genuine" or "bona fide" sale at fair market value.[8]

If the section applies, then any income or loss, capital gains or losses from the property will be attributed to the person from whom the property or substituted property was received while such person is resident in Canada. It should be noted that while the literature on this section often refers to these powers in relation to the Settlor, the section may apply to any transfer of property to a trust by any person.[9]

The terms of subsection 75(2) are not precise and the limits of the provision are far from certain. There has been limited jurisprudence which would assist in interpreting the provisions of the section and CRA has adopted administrative provisions that are broad and at times contradictory. The concern about subsection 75(2), however, goes beyond the attribution of income on property held by the trust on certain conditions. Even if the amount of the attributed income may be zero or nominal (such as for example, where the "property" in question is a coin which does not generate income), the provision may lead to potentially harsh results as a result of the possible application of subsection 107(4.1). That section of the Act provides that if subsection 75(2) was applicable at any time in respect of <u>any</u> property of the trust then the distribution of any property of the trust to beneficiaries on a rollover basis would, subject to certain exceptions, be denied. Thus it is important to understand the scope of subsection 75(2) and to take steps to avoid it wherever possible, not only to avoid the attribution rule of subsection 75(2) itself but also so as not to invoke the application of subsection 107(4.1).

The most often asked questions with respect to subsection 75(2) relate to: (i) what is a "condition" that creates a reversion; and (ii) what constitutes a "determination", "consent" or "direction" by the Settlor or transferor.

(i) Reversion

With respect to what constitutes a reversion of property for purposes of subsection 75(2), the provision will presumably cover revocable trusts notwithstanding "that the term "revert" is normally used to refer to a property interest rather than to a revocation under a reserved power".

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7 The Court in obiter agreed with the Tax Court that the Canada-Austria Income Tax Convention can override the application of the provisions of subsection 75(2) to a Canadian contributor of an Austrian trust. The Court did not give a final opinion on whether the Tax Court was correct in characterizing the Foundation as a trust but did state it was a "doubtful proposition" that the Foundation held its property in trust.

8 See CRA Document Number 2013-0480351C6 (June 11, 2013).

9 Justice Miller of the Tax Court of Canada in Sommerer stated at paragraph 87: "In effect, by the opening words of subsection 75(2) of the Act, only a settlor, or a contribution akin to a settlor is contemplated as being the defined person." The Federal Court of Appeal did not specifically address this point.

Where the trust indenture contains a provision that would allow the Settlor or other person who contributed property to a trust to reacquire the property, (as for example if the Settlor was a potential capital beneficiary), even if the ability to reacquire the property were remote, subsection 75(2) would apply. This is so even if the event which leads to the application of subsection 75(2) was not in existence at the time the trust was established nor in existence at the time the property was transferred to the trust.

In CRA Document Number 2002-0162855 dated April 25, 2003 the CRA was asked to consider a situation where a trust was established for the benefit of certain named individuals, and their present and future spouses and their issue. At the time the trust was settled the settlor was not within the class of beneficiaries but later became a discretionary beneficiary when he married one of the named beneficiaries. The word "may" in subparagraph 75(2)(a)(i) was relied on by CRA to conclude that even if there is a remote possibility the property can revert to a contributor, that is sufficient to invoke the application of subsection 75(2) even if the possibility did not exist at the time of establishment of the trust.[10]

Where, however, the contributor could reacquire the property by operation of law, such as the total failure of the trust for lack of beneficiaries, subsection 75(2) would not apply. Accordingly, a contributor of property to the trust, whether as Settlor or otherwise, should not be a capital beneficiary. If a Settlor/contributor is an income beneficiary, subsection 75(2) does not appear to have application.

It is clear, therefore, that if it is desirable to avoid the application of subsection 75(2), the trust should be irrevocable and under no circumstances should it be possible for the property to revert to the Settlor/contributor other than by operation of law on the failure of the trust.

It appears that subsection 75(2) will not apply where property is loaned to a trust since, in these circumstances, the transfer of property back to the person from whom it was received would not be a reversion of the property pursuant to the terms of the trust. See Howson v. The Queen.[11] ***CRA has indicated, however, that the loan must be a genuine loan made to a trust outside and independent of the terms of the trust.***

b) Directly or Indirectly

Subparagraph 75(2)(a)(i) provides that the attribution rule will apply where property is held by the trust "on condition that it may revert to the person from whom the property was directly or indirectly received". CRA's administrative position suggests that transfers must occur in the course of the same series of transactions in order for an indirect receipt of property to potentially attract the application of subparagraph 75(2)(a)(i).

[10] See also CRA Document Number 2009-0352711E5 (May 11, 2010); CRA Document Number 9304585 (May 17, 1993); CRA Document Number 2003-0050671E5 (April 5, 2004).

[11] 2006 TCC 644 (TCC).

c) Property Held by Trust on Condition: Options; Powers of Appointment

CRA has considered the possible application of subsection 75(2) in the context of powers of appointment. In the situation where a person settles a trust for the benefit of his/her spouse and the spouse is given a general power of appointment exercisable by will over the property of the trust or a special power of appointment, CRA's position is that subsection 75(2) will apply. This is because CRA takes the position that the settlor may be appointed as a capital beneficiary under the power of appointment and thus the contributed property can be returned to him/her. In addition if the terms of the trust provide that on a failure of beneficiaries the trust assets are to be distributed in accordance with the terms of the will of the settlor, CRA has taken the position that it would apply subsection 75(2) on the basis that by retaining that power the settlor has effectively retained a power to determine to whom the property will pass after the creation of the trust.

CRA distinguishes this from the situation where the terms of the trust provide that the trust property may devolve to the estate of the settlor's spouse even though there is a possibility that the settlor may be named as the beneficiary under the spouse's will. In this situation CRA has indicated that it would not apply subsection 75(2) because the property would devolve to the settlor not by virtue of the terms of the trust but rather by virtue of the terms of the will.

The CRA takes the position that the words "held on condition" are broad enough to cover an option to reacquire property contributed to a trust by a person who is not a beneficiary. This position has been criticized, as is noted that the property under option is not to revert to the option holder pursuant to the terms of the trust but rather pursuant to the terms of the option (a contractual right).

Subparagraph 75(2)(a)(ii) - "determination"

Subsection 75(2)(a)(ii) provides that where property is held on condition that it or property substituted therefor can pass to persons to be determined by the person at a time subsequent to the creation of the trust, subsection 75(2) will apply.

In a number of CRA interpretations, CRA has clarified that this subparagraph will apply if the contributor can select beneficiaries from a group of beneficiaries or can select the percentage of the trust fund. However the subparagraph will not apply, according to CRA, if the beneficiaries are named or predetermined and the contributor only retains the power to determine the quantum. However if the possibility of being able to determine the quantum of trust property is seen that the contributor can determine the beneficiaries to when property can be distributed, then subsection 75(2) may apply.

These interpretations are confusing and seem to draw distinctions that are difficult to comprehend. It has been noted that where "beneficiaries are named or are identified as an ascertainable class under the trust deed and cannot be modified by the settlor subsequent to the creation of the trust, subparagraph 75(2)(a)(ii) should not have application." This should also be the case, even where the power to distribute the property is fully discretionary such that one beneficiary may receive property to the exclusion of the

others. The reasoning is that this does not result in the possibility to determine beneficiaries as the beneficiaries have already been set out in the trust deed.

Paragraph 75(2)(b) - Consent; Direction

Paragraph 75(2)(b) provides that subsection 75(2) will apply where property is held on condition that during the existence of the person, the property or property substituted therefor shall not be disposed of except with the person's consent or in accordance with the person's direction. This provision would appear to apply to both dispositive and administrative powers (such as the power to make investment decisions).

A number of points should be noted about this provision. Firstly, if the reservation of the power is exercisable for a limited period of time or until the happening of an event, subsection 75(2) should not apply as the paragraph 75(2)(b) refers to "during the existence of the person".

Secondly, CRA has issued a number of interpretations relating to paragraph 75(2)(b) and subparagraph 75(2)(a)(ii) which consider a number of scenarios where subsection 75(2) will apply where a certain amount of control is retained by the contributor acting as a trustee.

In early technical interpretations, CRA advised that subsection 75(2) will apply in the following circumstances:

a) if the contributor is the sole trustee;

b) if the contributor is one of two trustees;

c) even if the contributor is one of three or more trustees;

i) if the trust indenture provides for the unanimous consent of the trustees to make decisions;

ii) and even if the trust provides for decision-making by majority vote, if the contributor must form part of the majority or if in fact at any time there are only two trustees or the settlor retains veto rights.

In later technical interpretations CRA appears to have reversed its earlier positions and has stated that subsection 75(2) "should not apply to a trust solely by virtue is the fact that the settlor is one of two or more trustees acting in their fiduciary capacity to decide issues" by majority or where standard terms of the trust require the decisions of the trustees to be unanimous.

CRA seems to distinguish between the situation where the settlor is acting in a personal capacity, and the situation where the settlor is acting in a fiduciary capacity under "standard terms of trust". In the case of the settlor acting in a fiduciary capacity it would appear that subsection 75(2) may not apply. However the CRA indicates that subsection 75(2)

will apply if the settlor is acting in a personal capacity where, for example, the trustees may not exercise the discretion permitted to them under the terms of the trust unless the settlor concurs with their decision or if the trust provides for majority decisions of the trustees so long as the settlor-trustee must form part of the majority.

With respect to the situation where the settlor is the sole trustee, however, CRA has consistently maintained that it will apply subsection 75(2).

Power to Appoint and Remove Trustees

The administrative position of CRA is that where "the settlor/trustee has the power to appoint, remove or replace any trustee", "it is a question of fact whether the property held by the trust could only be disposed of with the consent of the settlor/trustee". Thus, where a settlor/contributor also desires to be a trustee, one must compare the risk of subsection 75(2) applying against the benefit of conferring such a power on the settlor.

In an early technical interpretation, CRA Document Number 9407905 (June 6, 1994), the CRA stated that 75(2) may apply to a trust where the settlor or another contributor of property to the trusts was one of the trustees and also has the power to remove, appoint or replace trustees. It is a question of fact in each case whether 75(2) applies.

Letter of Wishes

CRA has expressed the view that signed letters of wishes can be considered part of the trust document. This is relevant in considering the possible application of subsection 75(2). It has been argued that the CRA position is not correct and that letters of wishes whether signed or not signed are only non-binding expressions of wishes and not to be recorded as part of the Trust document. They are just one of many factors to be taken into consideration in their decision making.

Subsection 75(2) vs. Other Attribution Rules

It should be noted that subsection 75(2) differs from the personal and corporate attribution rules contained in section 74.1 in that it is any income or loss from the property or property substituted therefor, or capital gains or capital losses realized from dispositions of the property or property substituted therefor, that are attributed to the transferor. In the case of the other attribution rules, it is only the income, loss, capital gains or capital losses allocated to (i.e., paid or made payable to) the beneficiaries of the trust that is attributed to the transferor.

The application of subsection 75(2) to any of the property held by a trust at any time will also restrict the ability of the trust to distribute property on a rollover basis to any persons other than the person from whom the trust received the property or the spouse of such person (see discussion on subsection 107(4.1) below).

Avoiding the Application of Subsection 75(2)

In order to avoid the possible application of subsection 75(2), the settlor or other contributor to the trust should not be a trustee or if the settlor or other contributor to the trust is to be a trustee, he or she should be able to be outvoted on every issue relating to the determination of which beneficiary will benefit and to what extent. The easiest way to ensure that this happens is to require a minimum of three trustees at all times with decision-making by majority. The trust indenture should not provide that the settlor/contributor must form part of the majority and should provide that, if at any time there are two trustees of whom the contributor/settlor is one, the trustees are constrained from making decisions concerning distribution to beneficiaries until a third trustee is appointed. Similarly, the settlor or transferor should not be given any right to veto distributions to beneficiaries.

Subsection 107(4.1)

In many cases, it may be considered that subsection 75(2) will not pose any significant problem as the only property which is contributed to the trust is the settled amount, which may not generate income. For example, an inter vivos trust is often used in an estate freeze where common shares are acquired by the trust. The trust maybe settled with a coin where does not generate any income. In order to avoid the application of other attribution rules, the trust will acquire the common shares with funds borrowed from an arm's length third party, usually a financial institution. Even though the application of subsection 75(2) in respect of the settlement amount may be insignificant, the greater concern is the possible application of subsection 107(4.1).

Generally, a distribution of capital out of a trust to a capital beneficiary in satisfaction of that beneficiary's capital interest is effected on a tax-deferred rollover basis. Subsection 107(2) of the Act provides that where any property of a personal trust has been distributed by the trust to a beneficiary in satisfaction of all or any part of the beneficiary's capital interest in the trust, the trust will be deemed to have disposed of the property for proceeds of disposition equal to the cost amount of the property to the trust. As a result, the trust will not realize any income or capital gain on the distribution of the property.

There are several important situations in which property cannot be distributed by a personal trust to a beneficiary in satisfaction of the beneficiary's capital interest in the trust on a rollover basis.

One such situation is the distribution of property which is capital property, resource property or land inventory by a spousal trust to a beneficiary other than the spouse while the spouse is alive. (subsection 107(4))

Another situation in which a trust cannot distribute property on a tax-deferred basis to a beneficiary is found in subsection 107(5) of the Act. Pursuant to this subsection, where a trust distributes property other than Canadian real property, Canadian resource property, timber resource property, property used in a business carried on in Canada through a permanent establishment, including rights and shares of a non-resident investment corporation, to a non-resident beneficiary, the trust is deemed to have disposed of the property for proceeds of disposition equal to its fair market value at that time. The beneficiary will be deemed to have acquired the property at a cost equal to its fair market value and generally to *have disposed of his or her interest in the trust for proceeds of disposition equal to the adjusted cost basis of that interest.*

By far the harshest exception, however, is found in subsection 107(4.1).

Subsection 107(4.1) provides that where subsection 75(2) is applicable at any time to any particular property of a trust, then the trust will not be able to distribute any property of the trust on a tax-deferred basis pursuant to subsection 107(2) to any beneficiary other than the person from whom the property or property substituted therefor was received (or the spouse or former spouse of that person) during the lifetime of that person. Instead subsection 107(2.1) will apply and the trust will be deemed to have disposed of the property and received proceeds of disposition equal to the fair market value of such property and the beneficiary will be deemed to have acquired the property at a cost equal to its fair market value. Generally, the beneficiary will not realize any capital gain in respect of the disposition of his or her capital interest in the trust.

Subsection 107(4.1) appears to apply in respect of the distribution of any property of a trust and is not limited to the property over which a person has the control described in subsection 75(2). Accordingly, the section could lead to very harsh results. For example, if a settlor contributed $100 to a trust and reserved one or more of the powers described in subsection 75(2) or subsection 75(2) otherwise applied because the settlor was a trustee in circumstances described above, even if the balance of the assets of the trust were contributed by others or acquired with borrowed funds, subsection 107(4.1) would potentially apply to the distribution of every asset of the trust.

In addition CRA has indicated that even after the condition which caused subsection 75(2) to apply has disappeared, subsection 107(4.1) may still apply.

It is noted that there is no provision in subsection 107(4.1) as there is in subsection 75(2) that restricts the application of subsection 75(2) once the settlor ceases to be resident in Canada. Thus 107(4.1) will continue to apply even after the emigration of the settlor.

As noted above, CRA has also taken the position that subsection 107(4.1) will apply even if the property to which subsection 75(2) applies has modest or nominal value with reference to the balance of the trust property and even if there may not have been attribution of income pursuant to subsection 75(2).

CRA has also indicated that while it may be possible to avoid the application of subsection 75(2) by transferring property from a trust to which subsection 75(2) applied to a new "clean" trust to which subsection 75(2) does not apply, subsection 107(4.1) will continue to apply to the new trust.

In addition subsection 107(4.1) may have retroactive application in that it appears to apply to trusts which were in existence at the time subsection 107(4.1) was enacted in 1988. There has been some concession by the CRA with respect to the retroactive effects of the provisions but it is quite narrow. In a comfort letter dated October 19, 2007 it was acknowledged that subsection 107(4.1) is too broad in its effect on distributions from a trust,

specifically when the trust was created before the introduction of subsection 107(4.1) into the Act.

In the letter, concern was expressed regarding the application of subsection 107(4.1) to an inter vivos trust settled in 1986 through a nominal settlement amount. The terms of the trust stated that decisions of the trust were to be determined by a majority of the trustees, including the settlor of the trust. Due to the fact that subsection 75(2) therefore appeared to apply to attribute any income earned on the settled amount to the settlor, subsection 107(4.1) would also apply to distributions of any property from the trust.

Given that the trust was established prior to 1989 (the year in which distributions of the trust were first subject to subsection 107(4.1)), CRA indicated that it was prepared to recommend to the Minister of Finance that subparagraph 107(4.1)(b)(ii) be amended so as not to apply in determining whether subsection 107(2.1) applies in respect of a trust distribution which occurs after 2001 and before 2009 where:

a) the distribution is of property to which subsection 75(2) had not applied at any time while the property was held by any of the trusts referred to in subparagraph 107(4.1)(b)(ii);

b) one of the trusts referred to in subparagraph 107(4.1)(b)(ii),

i) was created before 1989, and

ii) held, at a time before 1989, particular property that was, at that time, subject to subsection 75(2); and

c) none of the trusts referred to in subparagraph 107(4.1)(b)(ii) held any property (other than the particular property) that was subject to subsection 75(2).

The interplay between subsections 75(2) and 107(4.1) makes it imperative that these sections be considered when establishing a trust, and in particular, when determining the identity of the settlor, the trustees, the manner in which decisions are to be made by the trustees and the beneficiaries and their interests in the trust (income/capital).

It is also important to consider the possible application of these sections whenever a decision is made to effect an in specie distribution of assets to a beneficiary in satisfaction of such beneficiary's capital interest such as, for example, where an in specie distribution is being considered to avoid the application of the 21 year deemed disposition rule. In all cases where an in specie distribution is contemplated, it will be imperative to review the history of the trust, including how the trust has been funded, the identity of the settlor and other contributor, trustees and the beneficiaries, the property contributed to the trust and the manner of such contributions (sale, gift) and the terms of the trust with respect to how trustees make decisions to satisfy oneself that subsection 75(2) never applied.

1. STATEMENT OF INTENTION

1.1 Settlor's Intention. The Settlor hereby expresses his/her intention to establish an irrevocable trust for the benefit of the Beneficiaries (as hereinafter defined), upon the terms and conditions as hereinafter set forth.

1.2 Trustees' Agreement. The Trustees agree to stand seized and possessed of the Trust Fund, as hereinafter defined, upon the terms and conditions hereinafter set forth.

2. ESTABLISHMENT OF TRUST

***Annotation*: It is important to recall that in order for a trust to come into existence, it must satisfy the three certainties. Thus it must be clear that there is an intention to create a trust, that property be transferred to the Trustees and that the subject matter and the objects of the trust are described with sufficient certainty. There must be evidence that the Settlor (i) understands the terms of the trust; (ii) instructs the person preparing the trust with respect to the establishment of the trust; and (iii) provides the settlement amount. Cf. Kingsdale Securities Co. v. MNR [1974] 2 F.L. 760 (1975) C.T.C 14, 74 DTC 6674 (CA), as an example of a plan that went awry because of inattention to the three certainties. See also Antle v. The Queen 2010 FCA 280 (FCA).**

2.1 Statement of Intention. The Settlor hereby expresses [his/her] intention to establish an irrevocable trust for the benefit of the Beneficiaries, as defined in Article 3 of this Deed of Settlement, upon the terms and conditions as hereinafter in this Deed of Settlement set forth, by hereby transferring to the Trustees a Canadian silver dollar coin, which together with any other additional or further sums which may be received by the Trustees from time to time and any accretions or additions thereto, shall constitute a trust fund (hereinafter called the "**Trust Fund**").

***Annotation*: See above discussion regarding the settlement of the Trust with a coin to avoid the application of the attribution rules.**

2.2 Name of Trust. The Trust Fund hereby established by this Deed of Settlement shall be known as "**THE <*> FAMILY TRUST**".

***Annotation*: The Trust is not a legal entity. It is a relationship which arises when a person or persons (the "Trustees") holds property for the benefit of another or others (the cestui que trust or beneficiaries). The Trustees effect all acts in their capacity as Trustees and subject to the terms of the Trust instrument. However, it is common to give the trust a name for ease of reference.**

2.3 Acknowledgement of Receipt. The Trustees acknowledge receipt from the Settlor of a Canadian silver dollar coin (hereinafter referred to as the "**Settled Amount**").

***Annotation*: As CRA has been known to inquire about the original settlement property, it would be prudent for the Trustees to retain same in safekeeping event if there is other property comprising the Trust Fund.**

2.4 Additional Contributions. Subject to the Trustees' acknowledgment of receipt and the provisions hereinafter provided, any person, firm, association, syndicate, company or corporation, other than any person or entity who is a Beneficiary, may from time to time during the currency of this instrument convey, transfer or assign by deed, will or testamentary or inter vivos trust or in any other manner, any real, personal or mixed property to the Trustees to become part of the Trust Fund and such additional property so conveyed, transferred or assigned shall become and be subject to the terms and conditions herein set forth to the same extent and effect as if originally included in the Trust Fund. With respect to the acceptance of any additional contributions of property, the Trustees are hereby advised to obtain legal and tax advice concerning any tax and property implications to any of the Beneficiaries, as hereinafter defined, the transferor of property and/or the Trust Fund arising from the acceptance of any such additional contributions. For greater certainty, in no event shall the Trustees accept additional contributions of property from any person who is a Beneficiary, notwithstanding that such contributions would be made for valuable consideration.

***Annotation*: To avoid subsection 75(2) you may wish to include language to direct future readers to preclude contributions from certain persons. The above provides for no additional contributions from a beneficiary. See annotation herein regarding Sommerer relating to a fair market value sale by a beneficiary to a trust.**

2.5 Trust Accretions. The Trust Fund shall include all property of any kind whatsoever acquired by the Trustees, whether such property originated as a settlement, gift or accretion to the Trust Fund or property substituted therefor, or such property originated as a borrowing by the Trustees from any person, including property substituted therefor or any accretion thereto.

3. DEFINED TERMS

Definitions. For the purposes of this Deed of Settlement, the following terms have the following meanings:

3.1 "**Accumulation Period**" means the maximum period of time permitted by the laws of the province of Ontario for the accumulation of income.

***Annotation*: The Accumulations Act provides that the maximum period for the accumulation of income from the assets of a trust is 21 years. Therefore, if the Trust is to continue for longer than this you must ensure that when drafting the income provisions after 21 years all of the income is distributed. In the context of a discretionary trust this may require a default provision as to what is to happen to undistributed income both during the accumulation period and thereafter.**

3.2 “**Adult Beneficiaries**” means at any time, two or more of the individual Beneficiaries, as hereinafter defined, who have at such time attained the age of eighteen (18) years, and “**Adult Beneficiary**” means at any time any one of the individual Beneficiaries, who have at such time attained the age of eighteen (18) years.

3.3 “**Beneficiaries**” means collectively all of:

(i) <*>;

(ii) the Spouse or Surviving Spouse of <*>, as hereinafter defined;

(iii) <*>, being all of the children of <*> living at the date of this Deed of Settlement;

(iv) all of the children of <*> born at any time after the date of this Deed of Settlement;

(v) all of the issue of the children of <*> born at any time before or after the date of this Deed of Settlement;

(vi) an *inter vivos* trust, established for the benefit of any one or more or all of the Beneficiaries; and

(vii) a corporation of which the only shareholders are any one or more of the Beneficiaries.

Annotation:

1. As discussed earlier, the beneficiaries should be described with sufficient precision that the Trustees and if necessary a court can determine whether a particular person is intended to be in the class of beneficiaries. If there are to be different income beneficiaries and capital beneficiaries this should be clearly set out in the Trust.

2. In determining the beneficiaries of the Trust, it is necessary to consider the possible application of the attribution rules and in particular subsection 75(2). For example, as noted above, to avoid the application of subsection 75(2) or its companion subsection 107(4.1) it is important that neither the Settlor nor another person who has transferred or lent property to the Trust be a capital beneficiary of the Trust. It appears that such person can, however, be an income beneficiary.

3. In addition, in another CRA Document[12] which dealt with subsection 75(2) in the context of “common disaster” or “fall back” clauses, the CRA was asked to comment on the application of subsection 75(2) in four scenarios: two which contemplated that in the event of there being no identifiable beneficiaries

[12] 2002-0116535 (February 19, 2002).

of a trust the trust assets were to be distributed in accordance with the terms of the Settlor's spouse's will; and the other two which contemplated that in the event of there being no identifiable beneficiaries of a trust the trust assets were to be distributed in accordance with the Settlor's will. The CRA applied section 75(2) in all four scenarios on the basis that the property could revert back to the Settlor (with respect to distributions in accordance with the terms of the Settlor's spouse's will). With respect to distributions made in accordance with the terms of the Settlor's will, the CRA indicated that it would apply subparagraph 75(2)(a)(ii) on the basis that by retaining this power the Settlor had effectively retained a general power to determine to whom the property would pass after the creation of the trust. However, in a later commentary, in commenting again on scenarios 1 and 2, CRA noted that it had reconsidered its position and indicated that ss. 75(2) would not apply because if the property devolved back to the transferor spouse it would do so as a result of the terms of a will and not the terms of the trust as required by ss. 75(2).

4. It was noted earlier that generally property distributed in specie to a beneficiary in satisfaction of such beneficiary's capital interest in the trust can be effected on a rollover basis. One exception is if certain property is transferred to a non-resident beneficiary (see 107(5)). Consideration might be given to including trusts and corporations as possible beneficiaries to contemplate the possibility that a beneficiary is or may become non-resident of Canada at a time when the Trustees propose to make distributions. Reference should be made to CRA Document Number 2016-0669301C6 being Question 1 at the CRA Round Table at the 2016 CTF Annual Conference. The question dealt with distribution to a corporate beneficiary whose shareholder was a trust thereby "extending" the 21 year period and in its written answer, CRA stated that it would consider applying the General Anti-Avoidance Rule to such structures. In the oral presentation, the CRA official also alluded to the use of of corporate beneficiaries where an individual beneficiary is non-resident.

5. Associated corporation:

Where shares of a corporation are held by a discretionary trust, the identity of the beneficiaries may be relevant in determining whether the corporation is associated with another corporation for income tax purposes. Associated corporations must share the business limit for purposes of the small business deduction. The associated corporation rules in section 256 of the Act are the subject of much tax commentary and are rather complex. For purposes of this note, it should suffice to point out that associated corporation analysis considers control; ownership of shares; connection between those controlling each particular corporation; and possibly a degree of common ownership (typically at least 25% of the issued shares of any class). For example:

- *If all of the shares of Corporation I are owned by X and all of the shares of Corporation II are owned by X, the two corporations are associated.*

- ***If all of the shares of Corporation I are owned by X and all of the shares of Corporation II are owned by Y, the two corporations are not associated regardless of the relationship between X and Y. However, if the shares of Corporation II are owned by X as to 25% and Y as to 75%, then Corporation I and Corporation II would be associated if X and Y are related for income tax purposes(e.g., spouses; parent-child).***

Section 256 of the Act contains a number of deeming rules. In the case of a discretionary trust, subparagraph 256(1.2)(f)(ii) applies to deem each beneficiary to own all of the shares held by the trust. Thus, if the above definition of "Beneficiaries" applied, then each person listed in such definition would be deemed to own all of the shares held by the trust. Where a classic estate freeze has been implemented, the above deeming rule can lead unexpectedly to corporations being associated. Suppose:

- ***Father owns all of the shares of Corporation I and Mother owns all of the shares of Corporation II.***

- ***Mother implements an estate freeze of Corporation II so that while she retains voting control and holds redeemable retractable preferred shares (with an aggregate redemption value equal to the fair market value of Corporation II immediately prior to the estate freeze), a discretionary trust becomes the holder of all of the common shares of Corporation II.***

The effect of the deeming rule in subparagraph 256(1.2)(f)(ii) is that each beneficiary of the trust is deemed to own all of the common shares of Corporation II. Further, if a beneficiary is a minor, then a different deeming rule in subsection 256(1.3) deems a parent to own the shares owned by the minor. This results in Mother being deemed to own the common shares deemed to be owned by the minor beneficiary and also Father being deemed to own the common shares deemed to be owned by the minor beneficiary "Double deeming" is a recognized effect of these rules. Because Father is deemed to own the common shares of Corporation II, the two corporations will be associated.

Reference should also be made to Propep Inc. v. The Queen 2009 FCA 274 where the Federal Court of Appeal applied the deeming rule in subparagraph 256(1.2)(f)(ii) to a person whom the Court found was "beneficially interested" as defined in subsection 248(25), notwithstanding that subparagraph 256(1.2)(f)(ii) refers to a "beneficiary" rather than a person who is "beneficially interested" which encompasses a person who has a right whether immediate or future, absolute or contingent, conditional on or subject to the exercise of any discretion, to receive income or capital of the trust.

It should also be noted that the identity of trustees may also lead to associated corporation issues. As associated corporation analysis depends in part, on ownership of shares, the question is: where shares are held by the trustees of a trust, aside from the deeming rule discussed above, are the trustees considered to own the shares and if so, how is this apportioned among the trustees? CRA has given conflicting answers. In CRA Document Number 2005-0111731E5 (July 4, 2006\0, the CRA answer suggested that each trustee should be considered to own 100% of the shares held by the trust. In CRA Document Number. 2008-0285021C (October 10, 2008), the CRA answer suggested that the ownership of shares by each trustee should be calculated on a pro-rata basis (i.e., if there are three trustees, then each trustee could be considered to own 1/3 of the shares held by the trust). Finally, in CRA Document Number 2009-0330271C6 (October 9, 2009), the CRA suggested that the trustees as a group own the shares. As this seems to be a developing area, care should be given to choice of trustees to avoid inadvertently associating corporations for tax purposes.

3.4 "**Date of Final Division**" means the date (the "**Perpetuity Date**") that is twenty-one years following the date of the death of the last to die of **[the Settlor or any other relevant person]** and all of the issue of **[the Settlor or any other relevant person]** who are alive on the date of execution of this Deed of Settlement; provided that notwithstanding the provisions of this Paragraph, if the Trustees in their absolute discretion determine to terminate **The <*>Trust** and distribute the Trust Fund prior to the Perpetuity Date, the date which is so selected by the Trustees shall be the Date of Final Division. For greater certainty and without limiting the generality of the foregoing, the Trustees may, in their absolute discretion, exercise their authority to terminate **The <*>Trust** prior to the Perpetuity Date to avoid the deemed disposition of the Trust Fund pursuant to the provisions of subsection 104(4) of the *Income Tax Act* or any similar or successor section.

<u>Annotation</u>: The Trust property must vest within the perpetuity period which in Ontario is 21 years from the death of the last relevant life in being. When determining the Date of Final Division be aware of the application of the 21-year deemed disposition provision in subsection 104(4).

3.5 "**declared incompetent**" in reference to any person, means

(a) that a court of competent jurisdiction has declared that person to be incapable of managing property and has therefore appointed a committee, tutor, guardian or other custodian to manage the property of such person; or

(b) that the Trustees have obtained certificates from two (2) physicians licensed to practice medicine in the Province of Ontario, declaring the person to be incapable of managing property.

The acceptance by a person of his or her appointment as a Trustee hereunder shall be presumed to be acceptance by him or her of any disclosure by his or her physicians and other medical professionals of his or her medical information for the purpose of determining his or her capacity for acting or continuing to act as a Trustee hereunder.

3.6 "**Personal Representative or Representatives**" of a person means the executor and trustee or executors and trustees duly appointed by that person's last will and testament or administrator or administrators of that person's estate duly appointed by a court of competent jurisdiction, and if a person is declared incompetent, shall include a committee, tutor, guardian, or other custodian appointed to manage the person and/or property of such person by a court of competent jurisdiction or an attorney appointed pursuant to a continuing or enduring power of attorney or such other document of similar effect.

3.7 "**Income Tax Act**" means the *Income Tax Act*, R.S.C. 1985, 5th Supplement c.1, as amended from time to time.

3.8 "**Relationships**": Any reference in this Deed of Settlement to a person in terms of a relationship to another person determined by blood or marriage shall not include a person born outside marriage nor shall it include a person who comes within the description by tracing through another person who has been born outside marriage, provided that:

(a) any person who has been legally adopted shall be regarded as having been born inside marriage to his or her adopting parents,

(b) any person who is born outside marriage and whose natural parents subsequently marry shall be regarded as having been born inside marriage to his or her natural parents, and

(c) any person who is born outside marriage and who, in the opinion of the Trustees has had for some period during his or her lifetime a normal relationship of child and parent with one of his or her natural parents, shall be regarded as having been born inside marriage to such parent.

<u>Annotation</u>*: *This clause includes certain children born outside of wedlock. This should be discussed with a client to determine if this respects his/her wishes. You should also discuss with client whether children born out of wedlock should be included as personal beneficiaries.

3.9 "**Spouse**" includes, in addition to a legally married spouse who is living with <*>, at a relevant time, the person who is cohabiting with <*> in a conjugal relationship and has continuously so cohabited with <*> throughout the two year period immediately before that time. For greater certainty, <*> shall be deemed not to be living separate and apart from his/her Spouse if and for so long as the sole reason they are living separate and apart is that either of them has been institutionalized in a hospital, nursing home, convalescent home, retirement home or such other like facility, provided that they were not living separate and apart immediately before the day that one or both of them was institutionalized.

3.10 "**Surviving Spouse**" means that person who shall have been the Spouse of <*>, at the time of death of <*>.

Annotation: ***Additional parameters may be included such as the surviving spouse's rights ceasing on remarriage or cohabitation.***

Annotation: ***These definitions should be reviewed to ensure they reflect the wishes of the client.***

3.11 "**Trust**" means the trust established by this Deed of Settlement.

3.12 "**Trustee Act**" means the *Trustee Act*, R.S.O. 1990, c. T.23, as amended from time to time.

3.13 "**Trustees**" initially means the original Trustees and at any other time means the persons holding office as trustees or trustees of this Settlement at such time. Any reference in this Deed of Settlement to Trustees in the plural form shall include the singular form where the context so requires.

3.14 **Index and Headings.** The division of this Deed of Settlement into articles, paragraphs and subparagraphs and the insertion of headings are for convenience of reference only and are not intended to assist in the construction or interpretation of any of the provisions of this Settlement.

4. DISTRIBUTIONS OUT OF THE TRUST FUND

4.1 **Distributions of Income.** Until the Date of Final Division the Trustees may pay and apply the whole or any part of the annual net income derived from the Trust Fund to or for the benefit of any one or more of the Beneficiaries from time to time living and to the exclusion of any one or more of them, in such manner and in such proportions and under such terms, trusts and conditions as the Trustees in the exercise of an absolute discretion determine. Any annual net income which is not paid or applied in any year shall be accumulated and added to the capital of the Trust Fund at the end of each such year and dealt with as part thereof. If after the expiration of the Accumulation Period the Trustees continue to hold the Trust Fund, the Trustees shall pay and apply all of the annual net income to or for the benefit of any one or more of the Beneficiaries and to the exclusion of any one or more of them as the Trustees shall from time to time in their absolute discretion determine. In the event the Trustees fail to exercise their discretion as to the distribution of the annual net income within thirty (30) days of the end of a year, such amount as is not distributed in such year shall be paid to the Spouse or Surviving Spouse if then alive and, if not then alive, shall be divided among the Settlor's issue in equal shares per stripes.

Annotation:

1. Income for trust law purposes is different than income for income tax purposes. These differences can potentially give rise to certain anomalies which can be addressed in the drafting of the trust agreement.

For trust law purposes, form governs to determine the character of an amount as income or capital. See Re Waters, [1956] S.C.R 889 (SCC) and Widdifield on Executors and Trustees, 6th ed., chapter 7.2.2. For example, a cash dividend

(including a capital dividend) is considered income whereas a stock dividend or proceeds from a share redemption is considered capital. Where the foregoing amounts are received by a trust, it is necessary to review the trust agreement to determine if a particular beneficiary may receive the amounts in question. At first blush, based on trust law considerations of income and capital, it would seem that the former amount can be distributed to an income beneficiary whereas the latter amounts can be distributed to a capital beneficiary.

In contrast, for income tax purposes, all dividends (other than capital dividends) and are included in income. A share redemption may result in a deemed dividend for income tax purposes which would be included in income of the person whose shares are redeemed.

Where income and capital beneficiaries are one and the same, the differences between trust law characterization and income tax law characterization of amounts received may seem academic. It is worth noting however that if the trust realizes a capital gain on the sale of property, although the taxable capital gain (being ½ of the capital gain) is income for tax purposes, it is a capital receipt for trust law purposes. Therefore, the trustees would have to pay the taxable capital gain to capital beneficiaries as an encroachment on capital (if permitted under the trust agreement) rather than to income beneficiaries... This Annotated Discretionary Trust contemplates the same income and capital beneficiaries... However, if it is desirable that income beneficiaries (rather than capital beneficiaries) receive certain amounts, the trust agreement could:

- *make explicit reference to certain types of corporate distributions and state these are to be characterized as income; or*
- *adopt a definition of income in the trust agreement which correlates to income under the Act.*

In addition, certain amounts may be taxable for income tax purposes but may be a "nothing" for trust law purposes. This arises in cases of so-called phantom income for tax purposes. Deeming rules or elections under the Income Tax Act may give rise to income for tax purposes. For example, interest accrual rules in the Act may result in recognition of interest income in the year yet no interest income is received. If the trust agreement has adopted a definition of income correlating to income under the Act, then such phantom income (being income for purposes of the Act) would also be income under the trust agreement and accordingly could be paid or payable to an income beneficiary. In the absence of adopting a definition of income which correlates to income under the Act, reference can be made to the CRA's position on the allocation of phantom income is set out in CRA Document Numbers 2004-0069951C6 (June 21, 2004); 9425345 (February 24, 1995) and 2016-0634921C6 (June 10, 2016) and generally requires that the trust agreement provide the trustees with discretion to pay or make payable an amount equivalent to the phantom income, or the discretion to pay or make payable

amounts which are defined as income under the Act. This would effectively enable the particular phantom income to be deducted from the trust's income for tax purposes and taxed in the hands of the beneficiary.

2. Consider the duty to maintain an "even hand" and whether the Trustees should be given the authority to prefer one beneficiary or a group of beneficiaries over another or others.

3. Consideration should be given to whether the Trustees should be given explicit authority to allocate different amounts of income to different beneficiaries to take account of their tax status. For example:

CRA Document Number 2001-011294 (March 19, 2002) deals with an important question affecting many trustees. The CRA was presented with two situations, both involving essentially the same problem.

In the first situation, a fully discretionary trust holds both shares of a public corporation ("Pubco") and shares of a private corporation ("CCPC"), on both of which it has received dividends. Since one of its beneficiaries is a minor under 17, dividends which he or she receives from CCPC would be taxable under the "kiddie tax" provisions of section 120.4 of the Act, while the other is an adult, who is not affected by that provision.

The trustees propose to treat the distribution to the minor beneficiary as being paid out of the dividends received from Pubco and to treat the distribution to the adult beneficiary as being paid out of the dividends received from CCPC, in order to avoid the imposition of the kiddie tax.

In the second situation, the beneficiaries of the discretionary trust are an individual and a corporation ("Holdco"). The trust receives dividends both from a public corporation ("Pubco") and from a private corporation ("CCPC") which is connected with Holdco. It proposes to treat the distribution to the individual as being paid out of the dividends received from Pubco and to treat the distribution to Holdco as being paid out of the dividends from CCPC, in order to avoid the imposition of Part IV tax on the distribution to Holdco.

In each case the CRA was of the view that, since the trust was discretionary, the trustees could exercise their discretion to allocate the distributions in order to minimize the beneficiaries' tax liabilities.

In Goodman on Estate planning 2002 Vol. XI No. 1 after discussing CRA Document 2001 – 0112945 quoted above, Mr Goodman then went on to say

"A year or so ago I dealt with a somewhat similar situation in which, however, there was a non-discretionary trust, with two equal beneficiaries, one a Canadian resident and the other, a non-resident. The trust had received both interest income and dividends from Canadian companies and it wished to treat the distribution to the Canadian resident as being paid out of its dividend

income and to treat the distribution to the non-resident as being paid out of its interest income. At that time I advised the trustee that it had a fiduciary responsibility not to prejudice the interests of the Canadian resident by treating the distribution to him as being paid out of fully taxable interest income, instead of dividends which would entitle him to the usual gross-up and dividend tax credit, reducing his net tax on the distribution. This would not prejudice in any way the interests of the non-resident, who would be paying the same Canadian withholding tax and his own domestic tax on the distribution, whether the distribution was treated as being paid out of interest or dividends. Curiously, I was unable to discover any legal authority for my position, except for a general fiduciary responsibility not to prejudice either of the beneficiaries."

4.2 Distributions of Capital. At any time or times prior to the Date of Final Division, the Trustees may, in the exercise of an absolute discretion pay or transfer all or any part of the capital of the Trust Fund to one or more of the Beneficiaries to the exclusion of any one or more of them in such manner and in such proportion and upon such terms and conditions as the Trustees in the exercise of an absolute discretion decide. ***[See annotation above re the even hand rule.]***

Annotation:

1. Attribution In Respect Of Property Transferred To A Corporation

Any time a taxpayer transfers or loans property to a corporation, there is a potential that the attribution rule in subsection 74.4(2) may apply and require the taxpayer to include in income, as interest, an amount equal to an annual percentage of the value of the property so loaned or transferred. This subsection applies to loans and transfers made by an individual to a corporation if one of the main purposes of the loan or transfer may reasonably be considered to reduce the income of the individual and to benefit, either directly or indirectly, a designated person. This section will apply so long as:

(a) the transferor is resident in Canada;

(b) the corporation is not a small business corporation; and

(c) the designated person is a specified shareholder of the corporation.

A small business corporation is any Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which are attributable to assets that are either assets used principally in an active business carried on primarily in Canada by the corporation or a corporation related to it or shares or debt instruments of other "connected" small business corporations. For the purposes of the corporate attribution rules, a specified shareholder of a corporation is, generally, a person who holds at least ten percent of the shares of any class of the corporation or a related corporation (other than a small business corporation). Where the person is a beneficiary of a trust, the person is deemed to own that proportion of the shares of the corporation owned by the trust that the fair market value of the person's interest in the trust is of the total fair market value of all interests in the trust. Where a beneficiary's share of the income or capital of the trust is dependent upon the exercise of a

discretionary power, the beneficiary is deemed to own each share of the corporation which is owned by the trust. Accordingly, any time shares of a corporation which is not a small business corporation are owned or acquired by a trust, care must be exercised in order to ensure that the corporate attribution rules do not apply to attribute income to any person who has transferred property to the corporation.

This rule must be considered any time an estate freeze is contemplated whether by way of section 85, section 86 or section 51 as in each case there is a transfer of property to a corporation. For example, if an individual exchanges shares of a corporation on a tax-deferred basis under section 86 of the Act and a trust for the individual's spouse or minor children acquires more than 10% of the issued and outstanding shares of any class of the corporation, the corporate attribution rules in subsection 74.4(2) may apply. This follows from subsection 84(9) which provides that where a shareholder disposes of a share of the corporation as a result of the redemption, acquisition or cancellation of the share by the corporation, the shareholder is deemed, for the purposes of the Act, to have disposed of the share to the corporation. As a result, an exchange of shares pursuant to section 86 is considered to be a transfer of property to the corporation which may lead to the application of subsection 74.4(2). A similar result will follow if shares of one corporation are transferred to another corporation on a section 85 basis in exchange for shares of the second corporation and a trust for the transferor's spouse or minor children subscribes for at least 10% of shares of any class of the second corporation.

If the conditions of subsection 74.4(2) are satisfied, the transferor is deemed to have received an amount of interest in the taxation year computed at the prescribed rate on the "outstanding amount" of the loaned or transferred property.

It should be noted that the requirements for the application of subsection 74.4(2) must be satisfied on an annual basis. As a result, the rules will cease to apply if and when the original transferor ceases to be a resident of Canada. In addition, although the provision does not apply where the corporation is a small business corporation, it is not sufficient for the corporation to be a small business corporation at the time of the loan or transfer of property. If at any time subsequent to the original loan or transfer the corporation fails to meet the requirements of a small business corporation, the rules in subsection 74.4(2) may apply to deem the transferor to receive an amount of interest computed in accordance with the rules in that subsection.

There is an important exception to the corporate attribution rules where the only interest of the designated person in the corporation is a beneficial interest in a trust which owns shares of the corporation, and additional conditions are met (74.4(4)). In order for the exception to apply, the terms of the trust must provide that the designated person may not receive or otherwise obtain the use of any of the income or capital of the trust while he or she is a designated person in respect of the transferor, and the exception only applies if the designated person has not received or otherwise obtained the use of any of the income or capital of the trust. In addition, the trust must not make any deduction in respect of any income that has been paid to such designated person or in respect of any preferred beneficiary election made jointly with such designated person. Thus, if the freezor holds shares of a corporation which does not at the time of the freeze or may not in the future qualify as a small

business corporation, in order to invoke the "safe harbour" provisions of 74.4(4), it will be necessary in drafting any trust which will acquire the common shares on the freeze, to restrict the rights of any beneficiary while he/she a "designated person" in relation to the freezor. It should be noted that it would appear that these restrictions would still have to apply even if the freezor became non-resident.

Kiddie Tax

A tax on "split income", nicknamed the "kiddie tax" was introduced in the Federal Budget of February 16, 1999. This legislation was introduced in response to a series of cases involving income-splitting arrangements, which were objectionable to the Department of Finance. These included dividend sprinkling arrangements and management and technical services structures.

Dividend sprinkling involves the shares of a business being issued to family members directly or through a trust or holding company, often as part of a partial or complete estate freeze. The share capital provisions permit the directors to declare dividends to some family members (presumably those in lower income brackets) and not others. The quantum of the dividends could be determined by the directors as well. Thus, discretionary dividends could be sprinkled among family members in a tax advantageous manner.

Management services arrangements were typically utilized where an individual was a sole proprietor or a member of a professional partnership. In these cases, a management services corporation was incorporated by family members or a trust in favour of them to provide secretarial, administrative and/or technical services to the professional partnership. The corporation could also own the real estate leased to the professional partnership.

Aspects of this type of planning were approved of by the Supreme Court of Canada in the case of Neuman (see discussion above under Indirect Payments and Transfers) and by the Federal Court of Appeal in Ferrell v. The Queen [13].

In the case of Her Majesty The Queen v. Ferrell,[14] the taxpayer was settlor and sole trustee of a family trust. He also held voting, non-participating shares of a family holding company and the trust held the equity shares. In the year in question, the company accrued management fees in respect of services provided by the taxpayer and paid them up to the trust which in turn allocated them to the taxpayer's minor children under preferred beneficiary elections. The funds did not directly or indirectly find themselves into the hands of the taxpayer or his wife. The Minister included the accrued fees in the income of the taxpayer relying on the indirect payment provisions of 56(2) and (4) of the Act. The Tax Court disagreed and refused to apply subsection 56(2) and allowed the taxpayer's appeal.[15] The Federal Court, Trial Division agreed, applying Neuman v. The Queen. It affirmed that taxpayers can arrange their affairs so as to reduce taxes so long as there was no specific

[13] [1999] 2 CTC 101 (FCA).

[14] 99 DTC 5111.

[15] 97 DTC 1565.

legislation to preclude such action and this included the ability to use not only corporations but other structures such as trusts to save tax so long as the transactions were properly documented.

The Ferrell case represents the high water mark of success for taxpayers and the government's response was swift, at least with respect to income splitting with minors.

The measures introduced in the Federal Budget of February 16, 1999 eliminated the tax benefits of such Neuman-type structures to income splitting with minors by applying for the 2000 and subsequent taxation years a special tax at the top marginal rate of 29% on certain income of individuals aged 17 or under.[16] The types of income ("split income") which are taxed under this measure are:

(a) taxable dividends and other shareholder benefits on unlisted shares of Canadian and foreign companies received directly or indirectly through a trust or partnership; and

(b) income from a partnership or trust where the income is derived by the partnership or trust from the business of providing property or services to a business carried on by a relative of the child or in which the relative participates.[17]

Thus, almost all dividend income from private corporations received by minors would be subject to the kiddie tax.

In addition, the kiddie tax applies to capital gains from the disposition of shares of a private corporation where:

(a) The shares are disposed of by:

(i) A specified individual, as defined in subsection 120.4(1)[18]; or

(ii) By a trust, to the extent that part of the capital gain can reasonably be considered to be included in a specified individual's income pursuant to paragraph 104(13)(a) or subsection 105(2)[19]; and

(b) The shares are transferred, directly or indirectly, to a person who does not deal at arm's length with the specified individual; and

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16 Subsection 120.4(1) defines a "specified individual" as one who (a) has not attained the age of 17 years before the year; (b) at no time in the year was a non-resident; and (c) has a parent who is resident in Canada at any time in the year.

17 See subsection 120.4(1). Prior to amendments which were retroactive to taxation years beginning after December 20, 2002, the definition of split income referred to income from the provision of goods and services by a partnership or trust rather than income derived from the provision of property and services by a partnership or trust. Before such retroactive amendment, it was arguable that income derived from property, such as rental income, was not subject to the Kiddie Tax.

18 Subsection 120.4(4).

19 Subsection 120.4(5).

> (c) ***Taxable dividends on the shares would have been subject to the kiddie tax.***[20]

Where the tax applies, the capital gain is deemed not to be a capital gain and twice the amount that would otherwise have been the capital gain is deemed a taxable dividend.[21]

The extension of the kiddie tax to capital gains was announced in the 2011 federal budget and applies to dispositions occurring after March 21, 2011. The extension closed off certain income-splitting techniques related to capital gains, like strip transactions. A strip transaction involves the issuance of stock dividends to minors using preferred shares with a high redemption value but low paid up capital and adjusted cost base. The minor then sells the shares to a non-arm's length party in exchange for a promissory note. The minor realises a significant capital gain, which is taxed at his/her marginal rate. The non-arm's length party who acquired the shares then redeems the shares and repays the promissory note, without realising a capital gain with respect to the transaction.

Income that is subject to this tax will not be eligible for any deductions or credits other than the dividend tax credit and foreign tax credit.[22]***Thus, the basic personal credit is not available. The capital gains exemption is also unavailable in respect of capital gains to which the kiddie tax applies.***

To avoid double tax, income that is subject to the income splitting tax will be deductible in computing the minor's taxable income under Part I of the Act.[23] ***In addition, income subject to the income splitting tax will not be subject to the attribution rules***[24] ***and it would appear that there is no surtax charged (assuming the individual's tax liability does not reach the surtax threshold). An amendment to subsection 127.5 provides that alternative minimum tax ("AMT") payable will not be less than the tax on split income (and see also subsection 120.2(1) which provides that the tax on split income will be excluded from the calculation of tax payable from which AMT carryover amount may be claimed). To the extent that capital gains from the sale of shares by a trust are subject to the kiddie tax, paragraph 104(13)(a) and subsection 105(2) do not apply in respect of the amount.***

To ensure that the tax is collectible, parents are made jointly liable for the tax of their children.[25] ***This joint liability applies not only if the parent was active in the business from which the income that is subject to the new tax was derived but also applies to parents who are passive shareholders.***[26] ***Exemptions from this tax are as follows (applicable to certain types of individuals and certain types of income):***

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[20] Subsections 120.4(4) and 120.4(5).

[21] *Ibid*.

[22] 126(1), (2.1), (3).

[23] Subsection 20(1)(ww).

[24] Subsection 56(5) and 74.5(13)) in relation to 74.1, 74.4, 74.8, 75(2).

[25] Subsection 160(1.2).

[26] See 160(1.2)(b-(e).

(a) income not received as "private" dividend income, partnership income or trust income, for example: income from employment or personal services by the minor, dividends and shareholder benefits received on any listed shares;

(b) income from property inherited by the minor from his or her parent (but not, it would appear, if inherited from grandparents, aunts and uncles, etc.);

(c) income on other inherited property in any year during which the minor is in full-time attendance at a post-secondary educational institution or is eligible to claim the disability tax credit; and

(d) income received by minors who have no parent resident in Canada at any time in the year.[27]

It would appear that the objective of the legislation in targeting the income sprinkling and management services structures described earlier has been successful insofar as it relates to income splitting with minors. The split income tax applies to all arrangements that existed at the time the kiddie tax provisions were introduced, as there was no provision for grandfathering, and they apply regardless of whether or not it was intended to engage in income-splitting (i.e. there is no purpose test). Many taxpayers concluded that existing structures should be wound-up. However, it should be noted that there might still be reasons to retain existing structures.[28]

The following should be considered before winding up existing structures or when engaging in estate planning.

(a) The tax does not apply to some income sources, such as dividends and taxable capital gains from shares listed on a designated stock exchange or mutual fund corporation and taxable capital gains from the sale of any shares to arm's length parties;

(b) Income splitting can continue to be achieved through the payment of reasonable salaries to family members active in the business;

(c) The split income tax does not apply to spouses and adult children. It may be advantageous to continue to retain existing structures even if children are minors, as once they become adult and pursue post-secondary studies, income would be available to pay these expenses and would not be subject to the split income tax; and

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[27] See the definitions of "excluded amount" and "specified individual" under subsection 120.4(1).

[28] For a more comprehensive discussion, see Heather Evans, The Impact of the Proposed "Kiddie Tax" on income splitting arrangements 1999 Conference Reports 31.1 and David Stevens, Income Splitting – Planning in the New Regime 2000 Ontario Tax Conference).

(d) ***The traditional estate freeze is still useful as a mechanism for deferring tax on death.***

4.3 Date of Final Division. On the Date of Final Division the Trust Fund, or the amount thereof then remaining, shall be divided and distributed among such one or more of, to the exclusion of any one or more of, the Beneficiaries alive or in existence on the Date of Final Division, as the Trustees in the exercise of an absolute discretion shall decide. Failing such decision by the Trustees within three (3) months following the Date of Final Division, or to the extent that such exercise shall be void or shall not take effect in whole or in part, the Trust Fund, or the amount thereof then remaining, shall be paid and transferred to <@>, if he/she is alive on the Date of Final Division, provided that if he/she is not then alive, the Trust Fund, or the amount thereof then remaining, shall be divided and distributed among those of his/her issue as are alive on the Date of Final Division in equal shares per stirpes.

4.4 Payment to Minor Beneficiaries. Except as hereinbefore otherwise provided:

(a) if any capital of the Trust Fund or of any share thereof or any of the annual net income derived therefrom shall be payable or distributable, whether or not as a result of the exercise of the discretionary power vested in the Trustees, to an individual Beneficiary who is under the age of majority, the amount payable or distributable (hereinafter referred to as an “Infant's Share”) may be held and kept invested by the Trustees and so much of the annual net income and capital of an Infant's Share as the Trustees in their discretion may decide from time to time may be used for the benefit of such Beneficiary until he or she attains the age of majority and any annual net income of an Infant's Share not so used in any year shall be accumulated and added in such year to the capital thereof; and

(b) the Trustees are authorized to make any payment or distribution to or for the benefit of any Individual Beneficiary under the age of majority, or under other disability, to the parent, legal guardian, acting guardian or committee of such Beneficiary or to any one to whom the Trustees in their absolute discretion determine it advisable to make such payment, whose receipt shall be a sufficient discharge to the Trustees.

5. POWER TO RESETTLE IN WHOLE OR IN PART

5.1 Transfer to Another Trust. Notwithstanding any of the trusts, powers and provisions herein contained, the Trustees may in their absolute discretion from time to time and at any time or times, without infringing the rule against perpetuities applicable to this Settlement, transfer and convey the whole or any share, portion, part or parts of the Trust Fund save and except any such share, portion, part or parts which shall have indefeasibly vested in possession in one or more of the Beneficiaries, to any other trust or settlement whether established under or pursuant to the laws of the province of Ontario, any other province of Canada or any other jurisdiction whatsoever, to be held by the trustees of such other trust or settlement with and subject to the powers and provisions of such other trust or settlement provided that such other trust or settlement shall not infringe the rule against perpetuities applicable to this Settlement and one or more of the Beneficiaries of this Settlement alive at the date of such transfer and conveyance shall be one or more of the Beneficiaries of such other trust or settlement, and upon such transfer and conveyancing being made the trusts herein declared concerning the property comprised in such transfer and conveyance shall cease and determine and the said property shall for all purposes be subject to the trusts, powers and provisions contained in such other trust or settlement and be subject to and governed by the law of such other trust or settlement whether or not such law shall be the proper law of this Settlement. Notwithstanding the foregoing, in no event shall this power be exercised in such way as to result in any part of the Trust Fund or any property substituted therefor being paid or lent to or reverting to the Settlor or any person from whom trust property was received in any manner or circumstance whatsoever.

Annotation*: This resettlement provision provides flexibility to allow for the Trustees to deal with changing tax laws and changes in the circumstances of the beneficiaries, and permits parts or the whole of the Trust Fund to be re-settled for the benefit of one or more of the beneficiaries in Canada or elsewhere. AS noted earlier, the transfer of property to a trust, including a transfer to another trust, generally constitutes a disposition for tax purposes. This may result in a taxable transaction, unless exempted or a "rollover" rule in the Act applies. Certain trust-to-trust transfers are expressly excluded from being a "disposition" (see paragraph (f) of the definition of the term, "disposition" in subsection 248(1) of the Act) or may fit the requirements for a "qualifying disposition" in section 107.4 of the Act.

6. INVESTMENTS

6.1 Investment Powers – Alternative Clauses

(A) The investment powers of the Trustees shall be in accord with, and subject to, the provisions of the *Trustee Act*, but for greater certainty, the Trustees' scope of investment authority shall extend to property of any form in which a prudent investor might invest; provided that notwithstanding the foregoing and anything in this Deed of Settlement to the contrary, the Trustees are authorized to retain any shares and/or holdings in the capital of any one or more of the <*> as investments of the Trust for as long as they in their absolute discretion shall determine. The Trustees shall be fully exonerated from any liability for any loss that may happen to the Trust Fund by reason of any investment made by them in good faith.

OR

(B) The Trustees shall invest the Trust Fund in any investment or investments which the Trustees, in their absolute discretion, deem advantageous to the Trust Fund, not being limited to investments expressly authorized by law, including advances or loans, with or without security, to any person or persons, and in like manner from time to time to alter or vary such investments. When making investments, the Trustees shall not be subject to the criteria in planning for, or the requirements for diversifying, the investment of trust property which are prescribed by law for trustees. In particular, the Trustees may invest in any units, shares or fractional interests in any mutual fund, unit trust or other investment corporation, trust or partnership, whether or not:

(a) such units, shares or fractional interests are widely held or are closely held by any one or more of the Trustees, the beneficiaries and any other persons, trusts, corporations or other legally recognized entities; or

(b) the purchase of such units, shares or fractional interests might otherwise be considered as a delegation of the powers conferred upon the Trustees, as involving a commingling of all or part of the Trust Fund with the property of other persons, estates or trusts or as in any other respect a breach of the fiduciary responsibilities of the Trustees.

***Annotation*: The Trustee Act (Ontario) was amended in 1999 and again in 2001 to introduce the prudent investor rule and to permit delegation. The focus of the amendments is on the portfolio as a whole rather than individual investments. Investment in mutual funds and common trust funds are now expressly permitted.**

Trustees must consider seven criteria when making investment decisions. These criteria are set out in section 27(5) of the Trustee Act and include the requirement to diversify to the extent appropriate to the needs of the trust and general economic and investment market conditions (27(6)). Failure to comply with these requirements, including those pertaining to use of an investment agent, will leave the trustees without recourse to those sections of the Trustee Act providing relief for technical breaches of trust.

It should be noted, however, that sections 67 and 68 of the Trustee Act provide that the terms of a trust instrument can override any provision of the Trustee Act. If adherence to any of the seven criteria is not appropriate, consideration should be given to expressly ousting one or more of the criteria. For example, if diversification is not desirable (as for example in the estate freeze situation where it is contemplated that the trust may hold one asset for a long period of time), this obligation to do so should be amended and a specific direction included to retain certain assets. (See above example and see also Clare Sullivan Deadbeat vol. 28 #3 May 2010.) Consideration might also be given to permitting arrangements with discretionary portfolio managers if desired, i.e. excluding the requirements of s. 27.1 of the Trustee Act.)

6.2 Rights Incidental to Ownership. Should any company or corporation in which the Trust Fund may hold shares or other interests increase its capital the Trustees are authorised to subscribe for and take up the proportion of such increased capital to which as holders of shares or other interests in such company or corporation they may be entitled and to pay for the same out of the moneys of the Trust Fund or in the alternative to sell their rights to such allotment; and the Trustees are further authorised if in their opinion it would be in the best interests of the Trust Fund so to do, to subscribe for and pay for or purchase additional shares in any such company or corporation. The Trustees are further authorised to join in any plan for the reconstruction or re-organization of any such company or corporation or the amalgamation or merger of any such company or corporation with any other company or corporation or for the sale of the assets of any such company or corporation or any part thereof and they may in pursuance of any such plan accept any shares or securities in lieu of or in exchange for the shares or other interests held by the Trust Fund in such company or corporation. The Trustees are further authorised, if in their discretion they consider it to be in the best interests of the Trust Fund so to do, to enter into any voting trust, pooling or other agreement in connection with the interest of the Trust Fund in any company or corporation and to give any options they may consider advisable with respect to any such shares. The Trustees shall have the power and authority to deal with the interest held by the Trust Fund in any such company or corporation to the same extent and as fully as if they were the absolute owners thereof.

6.3 Appointment of Investment Counsel. In addition to and not by way of restricting the general investment powers of the Trustees, they shall be authorised to engage from time to time such person or persons as they consider advisable as investment counsel or investment advisors. The Trustees may rely and act upon the advice of such investment counsel or investment advisor(s) and further they may delegate directly to such investment counsel or investment advisor(s) the direct management of the whole or any part of the Trust Fund as the Trustees deem advisable and on such other terms as the Trustees consider advisable including for greater certainty delegated power to choose, acquire or dispose of investments from time to time and including the power to sub-delegate the power to choose, acquire and dispose of investments and the Trustees shall not be liable for any losses incurred as a consequence of the exercise or failure to exercise any such delegated powers by any such investment counsel or investment advisor(s). The Trustees may pay the proper fees and disbursements of such investment counsel or investment advisor(s) out of the Trust Fund, which fees and disbursements shall be charged to either income or capital or part to income and part to capital as the Trustees in the exercise of an absolute discretion shall determine.

> ***Annotation**: Subsection 27.2(2) of the Trustee Act provides that an agent who is authorised to exercise the investment functions of the Trustees shall not delegate that authority to another person. There has been some uncertainty as to whether an investment advisor can choose to invest in mutual funds as this could be considered a further delegation (see Re Haslam v. Haslam (1994), 114 D.L.R. (4th) 562). As noted above, sections 67 and 68 of the Trustee Act provide that the terms of the trust instrument can override any provision of the Trustee Act. Thus, inclusion of a specific provision that expressly permits such further sub-delegation and removes the concern about an investment advisor investing in mutual funds ought to be included.*

Note also the requirements of the Trustee Act for a contract with an "agent" for the provision of investment service on a discretionary basis.

<u>Annotation</u>: With the amendments to the Trustee Act in 2001, a trustee can now enter into a contract with an "agent" for the provision of investment services on a discretionary basis. The requirements of the agency relationship are carefully defined, including a written agreement, the development of an investment plan and periodic reporting. The premise is that the prudent choice and ongoing supervision of an investment agent is a duty which prudent trustees can be trusted to carry out.

There is, however, some uncertainty as to whether an investment advisor can choose mutual funds as an investment. This uncertainty is based upon the decision in Haslam v. Haslam, (1994) 114 D.L.R. (4th) 562. In this case Judge Rosenberg held that an investment in a mutual fund was an unauthorized delegation of investment decision making. While mutual funds are now expressly deemed to not violate the rule against delegation, there is a concern that if an investment agent, to whom decision-making has been delegated, invests in a mutual fund, that this will be seen as a sub-delegation. Accordingly, this clause removes this concern.

6.4 Conversion of Assets with Power to Postpone. The Trustees may retain any asset of the Trust Fund regardless of whether such asset is personalty, realty, moveable, immoveable, intangible or of any other form whatsoever, (notwithstanding that it may not be in the form of an investment in which Trustees are authorized to invest trust funds and whether or not there is a liability attached to any such asset) for such length of time as the Trustees in their absolute discretion deem advisable, including the entire term of the administration of the Trust Fund; provided that it is not intended that this power contradict or delay any direction or authority to the Trustees to distribute any asset or portion of the Trust Fund to any Beneficiary at any particular time.

The Trustees shall not have a duty to dispose of and shall not be compelled by any Beneficiary or by any Court to dispose of any asset of the Trust Fund for any reason including because of yield or lack thereof or lack of diversity provided that the Trustees may sell, transfer, exchange or otherwise dispose of them at any time or times, in such manner and on such terms as they consider necessary or advisable. It is not intended that this power contradict or delay any direction or authority to the Trustees to distribute any asset or portion of the Trust Fund to any Beneficiary at any particular time.

7. AUTHORITY TO BORROW

7.1 Borrowing. The Trustees may from time to time, in the exercise of an absolute discretion, borrow on behalf of the Trust Fund such sum or sums of money for any purpose whatsoever which money may be repayable with such interest or without interest as the Trustees shall determine is appropriate in the circumstances and the Trustees may mortgage, pledge or charge the income and/or the capital of the Trust Fund (both present and future) or any parts thereof to secure repayment of any money so borrowed. The Trustees are authorised to execute and deliver such instruments evidencing indebtedness and such instruments evidencing the security as to the Trustees appear necessary or desirable. The Trustees may also, in their absolute discretion, guarantee and for that purpose mortgage, pledge or charge the income and/or the capital of the Trust Fund (both present and future) to facilitate the borrowings of any one or more of the Beneficiaries or of any company or corporation the shares in the capital stock of which constitute part of the Trust Fund or which are owned or controlled by any one or more of the Beneficiaries.

8. AUTHORITY TO LEND

8.1 Loans to Beneficiaries. The Trustees may, from time to time in the exercise of an absolute discretion, lend moneys to any of the Beneficiaries (including a Trustee) for such length of time and upon such terms and at such rate of interest or without interest and with such security or without security as the Trustees, in the exercise of an absolute discretion, shall consider advisable.

9. REAL PROPERTY

9.1 Real Property. The Trustees shall have unfettered discretion to sell, mortgage or lease any real or leasehold property that forms part of the Trust Fund upon such terms and conditions as the Trustees think fit. The Trustees may accept surrenders of such leases and tenancies. The Trustees my expend money in repairs and improvements and generally manage such property. The Trustees may give any options with respect to such property as they consider advisable. The Trustees may renew and keep renewed any mortgage upon any such property and may pay off or renegotiate any mortgage which may be in existence at any time.

10. JOINT VENTURES AND PARTNERSHIPS

10.1 Joint Ventures and Partnerships. The Trustees may join in any syndicate, partnership or joint venture, contributing all or part of the assets of the Trust Fund as the contribution of the Trust Fund thereto and they may enter into agreements with co-investors which limit their rights to buy or sell assets of the Trust Fund.

11. SPECIAL POWER TO SELL, VALUATIONS AND SPECIE DISTRIBUTIONS

11.1 Special Power to Sell. In addition to sales in the normal course, the Trustees may dispose of the investments and assets of the Trust Fund in whole or in part, at public auctions, by tender or private sale, all upon such terms and conditions and for such sum or sums as the Trustees consider advisable. The Trustees may make partition with the co-owners or joint owners who have any interest in any property real or personal in which the Trustees have an interest, and may make such partition, either by sale or by set off or by private agreement.

11.2 Transactions with Trustee. A Trustee may at any time and from time to time sell assets to, or purchase assets from the Trust Fund, provided that the purchase price, terms and conditions of any such sale or purchase shall be approved by the Trustees other than the Trustee to or from whom such sale or purchase is being made and the Trustees shall not be required to obtain the approval of any Court as a condition to any such sale or purchase.

<u>Annotation</u>: In the absence of an applicable provision in a trust instrument, at common law, a trustee is not permitted to self-deal without court approval. This clause permits such transactions without court approval.

11.3 Valuations and *Specie* Distributions. In setting aside any fund or in making any division of the income or capital of the Trust Fund or any part thereof, or in paying or transferring any share or interest thereof, the Trustees may fix the value of the Trust Fund or of any investments or assets forming part thereof, and may divide, set aside, pay or transfer over *in specie* or otherwise all or part of the investments or assets forming the Trust Fund using the value so fixed by the Trustees, and the value so fixed by the Trustees shall be final and binding on all Beneficiaries and other persons concerned.

12. GENERAL ADMINISTRATIVE POWERS

<u>Annotation</u>: While Trustees need to be involved in the decision-making process, it is possible for Trustees to delegate to one or more Trustees the power to sign documents and carry out or implement other decisions once the Trustees collectively have made such decision.

12.1 Operate Accounts. The Trustees may for the purposes of the Trust Fund open and operate any account or accounts with any bank, trust company, investment dealer, stockbroker or financial institution in any jurisdiction.

12.2 Signing Authority. The Trustees may appoint one or more of the Trustees or any other person or persons to sign any or all banking documents, stock transfers, receipts, promissory notes, other negotiable instruments and any other documents of any kind required to be signed on behalf of the Trustees at any time.

12.3 Voting Trust. The Trustees may in their absolute discretion enter into or establish any voting trust agreement in respect of any shares, securities or property which form part of the Trust Fund as the Trustees consider appropriate and the Trustees may, but need not, participate in the exercise of such votes.

12.4 Power to Sue and Settle. The Trustees may from time to time institute, prosecute and defend any suit, action, arbitration or other proceeding affecting the Trustees or the Trust Fund and may pay the fees, costs and expenses thereof out of the Trust Fund. The Trustees may compromise or compound any debt owing to the Trust Fund. The Trustees may compromise or settle any claim of or against the Trustees or the Trust Fund upon such evidence or opinion as the Trustees shall deem sufficient.

12.5 Power to Pay Expenses. For the purposes of clarification, and not in any way to limit the powers of the Trustees hereunder, the Trustees are authorised to settle and to pay and satisfy out of the assets or property of the Trust Fund (charging the same against income or capital or part against income and part against capital as the Trustees in the exercise of an absolute discretion shall determine) any of the following obligations:

(a) the amount of any income, gift or other tax or any duty payable to any government to which the Trust Fund is obligated arising from or in connection with the establishment, execution, operation, management, distribution or termination of the Trust Fund or otherwise related to the Trust Fund;

(b) the amount of any expenses payable to the Trustees hereunder in respect of attendance at the Trustees' meetings;

(c) the amount of any legal or other expenses necessarily or reasonably incurred in connection with the establishment, execution, management, operation, distribution or termination of the Trust Fund;

(d) the amount of any reasonable expenses for making and changing investments, or for purchasing, exchanging or leasing any property, including brokers' commissions and charges, auditors' fees and legal fees.

12.6 Separate Funds or Common Funds. The Trustees may in the exercise of an absolute discretion maintain the Trust Fund in one common fund or may set aside one or more separate funds for any Beneficiary or group of Beneficiaries and the Trustees shall have the power to invest such separate funds for such Beneficiary or a group of Beneficiaries only and shall have the power to re-allocate assets from one trust to another or discontinue one or more or all trusts so established and to re-establish such separate trusts or common funds as they from time to time deem it advisable so to do.

***Annotation*: In the absence of provisions to the contrary in the trust instrument at common law, Trustees are prohibited from commingling trust assets. Thus to the extent there are separate trust funds created, they must be maintained separately. This clause permits the pooling of separate trust funds.**

12.7 Incorporation. The Trustees may incorporate or join with any other person or persons in the incorporation of any corporation under the laws of any jurisdiction in the world at the expense of the Trust Fund with limited or unlimited liability for the purpose, *inter alia*, of engaging in any business and/or of purchasing and holding the whole or any part of the Trust Fund. The consideration for the sale or transfer of the Trust Fund or any part thereof to any such corporation incorporated pursuant to this clause may consist wholly or partly of fully paid shares, debentures or other securities of such corporation. Any Trustee may but need not serve as a director or officer of any such corporation so long as s/he is a Trustee of the Trust Fund but if s/he is a director or officer of any such corporation s/he shall forthwith resign upon ceasing to be a Trustee, unless the Trustees determine otherwise.

12.8 Carry on Business. The Trustees may carry on any business whatsoever and either independently or in partnership with any individual, trust or corporation which can in the opinion of the Trustees be carried on advantageously by the Trust Fund and the Trustees shall have power to do all things necessary or advisable for the carrying on of any such business.

12.9 Registration of Securities. It shall not be necessary for any securities or assets of the Trust Fund to be registered in the name of the Trustees and the same may, in the discretion of the Trustees, be registered in the name of any agent or nominee of the Trustees.

12.10 Safekeeping and Insurance of Securities and other Assets. The Trustees may arrange for such safekeeping and storage of securities, other assets of the Trust Fund and of records belonging to or relating to the Trust Fund as the Trustees in their discretion consider appropriate and the Trustees may place such insurance upon securities and other assets at the expense of the Trust Fund or refrain from placing insurance on some or all of the securities and other assets as they consider it appropriate so to do.

12.11 Professional Advisors to the Trustees. The Trustees may employ and act upon the advice of such professional or other experts and consultants including without limitation lawyers, valuators, accountants, surveyors, auctioneers, actuaries, corporate agents and nominees, as the Trustees consider advisable in the discharge of their duties and may delegate in writing to such agents all or any of their powers conferred on them herein. The Trustees may pay the proper fees and disbursements for such professional or other experts and consultants out of the Trust Fund, charged either to income or capital or part to income and part to capital as the Trustees consider appropriate.

The Trustees may act upon the opinion or advice of or upon information obtained from any such professional or other experts and consultants and the Trustees shall not be responsible, answerable or accountable for any loss, depreciation or damage occasioned to the Trust Fund by their acting or not acting in accordance therewith.

In the event that the Trustees require advice or assistance and a Trustee is qualified in the relevant field and the Trustees consider that s/he is the most suitable person from whom to obtain the necessary advice or assistance, then they may retain such Trustee notwithstanding that s/he is a Trustee and s/he shall be entitled to receive full professional or non-professional fees for the services rendered to the Trustees and the Trustees shall be entitled to rely upon his/her assistance having regard to the field of expertise without reference to the fact that s/he is a Trustee.

> ***Annotation*: At law trustees are not permitted to delegate their duties. The above clause will allow the trustees to hire agents such as lawyers, real estate agents, brokers and accountants, to perform some of their functions. It is important to note that all decision-making must be completed by the trustees but the carrying out of decisions can be delegated to agents pursuant to this clause. The clause goes on to provide that the agents can be remunerated out of the trust. In the event an agent performs a function which is a function the trustee is expected to perform, such as the preparation of the trustee's accounts and the trust pays the agent's remuneration, the agent's remuneration would be deducted from the compensation allowed to the trustees.**

12.12 Accounting by Trustees. The Trustees may keep the accounts of this Settlement in any form and shall not be obliged to maintain accounts in the form otherwise required under the laws of Ontario or any other jurisdiction.

12.13 Depreciation or Depletion Reserves. The Trustees may provide for depreciation or depletion reserves to be charged against the net income arising from depreciable or depleting assets held in the Trust Fund. The rate of depreciation or depletion to be taken annually shall be such rate as the Trustees may determine. Any sums reserved for depreciation or depletion shall be set aside in each year and shall be deemed to form part of the capital of the Trust Fund. Notwithstanding any other provisions of this Deed of Settlement, the income arising from the Trust Fund shall be the net income after providing for the aforesaid reserves for depreciation or depletion.

12.14 **Elections, etc.** The Trustees shall have full, absolute and unfettered discretion from time to time and at any time or times, either alone or in conjunction with a Beneficiary, to make or refrain from making any election or elections, designations, determinations, distributions and/or allocations for the purposes of the *Income Tax Act* or any similar legislation of any province or other jurisdiction in force from time to time as they in their absolute discretion deem to be in the best interests of the Trust Fund and/or the Beneficiaries, either alone or in conjunction with a Beneficiary, notwithstanding that such election or elections, designations, determinations, distributions and/or allocations may or would have the effect of conferring an advantage on any one or more of the Beneficiaries or could otherwise be considered but for the foregoing as not being an impartial exercise by the Trustees of their duties hereunder or as not being the maintaining of an even hand among the Beneficiaries. Where any specific funds or shares are created under this Trust Fund, the Trustees shall have the absolute power to determine which specific assets shall form such fund or share, as the case may be, unless otherwise expressly provided in the Trust Fund. The Trustees are specifically exonerated from any responsibility with respect to making or not making any such election or elections, designations, determinations, distributions and/or allocations if they act *bona fide* in the exercise of such powers. The exercise of a discretion by the Trustees shall be conclusive and binding on all Beneficiaries hereof and notwithstanding any of the foregoing provisions, the making and filing of an election or elections, designations, determinations, distributions and/or allocations for income tax purposes shall not in and of itself create a vested interest in any Beneficiary to any portion of the Trust Fund.

13. TRUSTEES

13.1 **Number and Appointment of Trustees.** There shall at all times be at least three (3) and not more than five (5) Trustees. Additional Trustees may be appointed from time to time as deemed necessary or advisable and at any time that there are less than five (5) Trustees by an appointment in writing executed by <*> while s/he is alive and a Trustee and thereafter by the remaining Trustee or Trustees or failing him, her or them, by a majority decision of the Adult Beneficiaries, who are *sui juris*. No appointment shall be valid or effective unless the proposed Trustee has in writing agreed to act and a copy of such appointment is sent by prepaid registered mail or delivered personally to each of the other Trustees.

> ***<u>Annotation</u>: See earlier discussion above regarding the possible application of ss75(2) if this power is given to the Settlor/Contributor.***

13.2 **Qualifications of Trustee.** No Person shall at any time be eligible to be appointed as a Trustee pursuant to Paragraph 13.1, or to act as a Trustee at any time, other than:

(a) an individual at least 18 years of age who is resident in Canada for purposes of the *Income Tax Act*; who is not the Settlor or anyone who has contributed property to the Trust Fund; who has not been declared incompetent; and who does not have the status of bankrupt; or

(b) a corporation incorporated under the laws of Canada or of a province that is a resident of Canada for purposes of the *Income Tax Act* and does not have the status of bankrupt.

For greater certainty, a Trustee shall immediately cease to be a Trustee at any time that he or she fails to meet the qualifications set out in Paragraph 13.2(a) or (b), as applicable.

13.3 Retirement of Trustees. If there is only one (1) Trustee, such Trustee may resign only upon an Order of a Court of competent jurisdiction where the Trust Fund has its *situs*. If there is more than one (1) Trustee then any Trustee may retire on thirty days' written notice sent by either registered mail, postage prepaid or by telegraph, telex, fax or similar method of communication, charges prepaid to the last known addresses of, or personally served upon, the remaining Trustees and the Adult Beneficiaries who are *sui juris*, if any, who have received any income or capital from the Trust Fund within the preceding four year period. If a Trustee desires to retire on less than thirty days' written notice then the remaining Trustees may unanimously agree to accept such shorter notice as they consider appropriate. A Trustee shall cease to be a Trustee and shall be deemed to have retired upon becoming incompetent of managing property.

13.4 Removal of Trustees – Alternative Clauses

(A) At any time while <*> is a Trustee s/he shall have the power to remove a Trustee if s/he considers it to be in the best interests of the Trust to do so, which shall be a matter in the absolute unquestioned discretion of <*>, provided that notice in writing of such removal shall be given to such Trustee and to all other Trustees, which notice shall be sufficiently given if sent by prepaid registered mail to the last known address of each person entitled to receive such notice.

OR

(B) Whenever there are at least three Trustees and in the opinion of the remaining Trustees other than the one to be removed, a Trustee has become unwilling or unable to act or to continue to act as a Trustee or the best interests of the Trust Fund require the removal of a Trustee, which shall be a matter in the absolute unquestioned discretion of the remaining Trustees, then in every such case such Trustee may be removed provided that notice in writing of such removal shall be given to such Trustee and to all other Trustees, which notice shall be sufficiently given if sent by prepaid registered mail to the last known address of each person entitled to receive such notice. Notwithstanding the foregoing, **[Name of**

<*>] shall not be removed as a Trustee unless s/he has been declared incompetent of managing property.

<u>Annotation</u>:* *See earlier discussion above regarding the possible application of ss75(2) if this power is given to the Settlor/Contributor.

13.5 Decisions of Trustees. All decisions of the Trustees shall be made by a majority vote. **[Note: The following sentence can, if so desired, be deleted if the Settlor or other transferor of property to the Trust is not one of the Trustees.]** For greater certainty and without restricting the generality of the foregoing, at any time that <*> is a Trustee and is resident of Canada and there are fewer than three (3) Trustees then any decision effected or document or instrument executed by the Trustees, excluding a decision effected or document or instrument executed in connection with the appointment of a new Trustee, shall be an invalid and ineffective act of the Trustees. A certificate signed by any one Trustee shall be prima facie evidence of the number of Trustees in office at any time and of the names of such Trustees. Without in any way affecting the validity of any act of a majority of the Trustees as hereinbefore provided, it shall be the duty of the majority of Trustees who effect a decision or execute any document or other instrument to inform any Trustees not present at the time such decision is made or who are not signatories to such document or instrument.

<u>Annotation</u>: See the earlier discussion regarding section 75(2) with respect to the decision-making by the trustees when one or more of their number includes the Settlor or other person who has transferred or lent property to the trust.

13.6 Remuneration of Trustees. Each Trustee who is not a Beneficiary of the Trust Fund shall be entitled to charge to the Trust Fund all expenses reasonably incurred by him in attending meetings of Trustees and in carrying out the duties of a Trustee and in addition such Trustees shall be entitled to receive reasonable compensation for their care, pains, trouble and responsibilities in and about the affairs of the Trust Fund. In the event that one or more of such Trustees declines such compensation, the aggregate compensation shall be reduced so that no Trustee accepting such compensation shall receive more than the share he or she would receive if all such Trustees had accepted compensation. If the amount of compensation is approved by all of the Trustees and a majority of the Adult Beneficiaries, who are *sui juris*, then the settlement of such compensation shall be final and binding upon all persons concerned. In the absence of agreement, compensation shall be determined by a Court of competent jurisdiction.

Notwithstanding the foregoing, in no event shall the Settlor be entitled to receive any compensation for expenses or for his care, pains, trouble and responsibilities in and about the affairs of the Trust Fund nor shall a Trustee be permitted to receive such compensation from a Beneficiary or from a Trustee acting in his or her personal capacity.

<u>Annotation</u>:* *The statutory basis for fees charged by Trustees is section 61 of the Trustee Act. Section 61 provides as follows:

(1) A trustee, guardian or personal representative is entitled to such fair and reasonable allowance for the care, pains and trouble, and the time expended in

and about the estate, as may be allowed by a judge of the Ontario Court (General Division).

(2) The amount of such compensation may be settled although the estate is not before the court in an action.

(3) The judge, in passing the accounts of a trustee or of a personal representative or guardian, may from time to time allow a fair and reasonable allowance for care, pains and trouble, and time expended in or about the estate.

Over time a court-recognized "tariff" has developed as to what is fair and reasonable compensation. This is not a legislated tariff but is a guideline. It is subject to increase or decrease depending upon the facts. In some cases it has been ignored in certain cases and other factors have been taken into account, such as fees on the basis of docketed time.

The guidelines apply percentages to the various components of the trustees' accounts. It provides as follows:

2 ½ % of the value of the capital receipts being original assets realized;
2 ½ % of the value of the capital disbursements;
2 ½ % of the value of revenue receipts;
2 ½ % of the value of revenue disbursements;
an annual care and management fee of 2/5th of 1 % of the average market value of the capital of the trust.

With respect to capital disbursements, it is important to bear in mind that the fee cannot be taken into account until the asset is either liquidated and disbursed i.e. to pay a debt or distributed to a beneficiary either in specie or in its liquidated form. If original assets are thus maintained and distributed in specie, it is only when the distribution is actually made that the capital disbursement fee can be taken.

The care and management fee is generally applicable where there is a trust to be held for a period of time.

In terms of claiming compensation, it is becoming increasingly apparent that the courts will not automatically approve a claim based on the guidelines but will instead use the guidelines as one factor to consider and will measure the number against other factors such as the time spent (here docketed time is useful), the results achieved, the skill and ability displayed, complexity of the trust, length of the administration and the care and responsibility needed. The trustees should collect and maintain evidence to substantiate their claim.

It is important to note that the compensation allowed trustees is intended to be for all services provided by trustees. To the extent the trustees engage agents to perform functions that they should be performing and the trust pays for this third party service, the amount paid will in most cases reduce trustee's compensation dollar for dollar. The courts have accepted that payment of certain specialized services will not reduce compensation, ex. Real estate agent fees, fees for tax return preparation, investment counsel fees.

In terms of charging compensation to the income and capital beneficiaries, the fees on account of capital receipts and disbursements are charged to the capital beneficiaries and those applicable to revenue are charged to the income beneficiaries. The care and management fee is generally charged 2/3 to capital and 1/3 to revenue but this general rule can be modified.

Sometimes issues arise about where disbursements should be charged. The general rule focuses on who benefits from the disbursement. It also takes into consideration that charging a disbursement to capital will ultimately impact the income beneficiary, as the capital to be invested is reduced thereby lowering the income that will be generated. This area is complicated and any more detail is beyond the scope of this annotation.

Trustees are generally not entitled to take compensation until their accounts to which the compensation claim relates have been approved by the court or unless the trustees have obtained the approval of 100 % of the beneficiaries representing all of the interests in the trust Generally, obtaining 100% approval is not possible. This is due to the fact that most trusts involve minor beneficiaries or have unascertained beneficiaries. The trust could provide for a pre-taking of compensation as passing accounts on a regular basis to claim compensation could prove expensive over the term of the trust.

When a solicitor acts as a trustee and also provides legal services to the trust, questions often arise as to whether the solicitor is entitled to both compensation for acting as the trustee and to compensation for legal services rendered. Section 61(4) of the Trustee Act (Ontario) seems to give support to the proposition that the solicitor is not disentitled from charging both fees in this situation. However, the fees need to be justifiable. To the extent the solicitor is performing trustee functions and charging legal fees for those same services, the quantum of legal fees must be deducted dollar for dollar from their claim for trustee compensation. One cannot be compensated twice for performing the same service. In our office, we set up two matters. When we are providing legal advice and services, such as bringing a passing of accounts application, we docket to one matter and when we are performing trustee functions, like the preparation of accounts or the gathering of information pertaining to assets, we docket to another matter. This way it becomes a relatively easy exercise to determine the amount of our fees which must reduce trustee compensation claim. Directors' fees charged where the trust is the sole shareholder will also be taken into account in determining compensation.

Given the uncertainties both as to the quantum of compensation and when it can be claimed, trust companies that are named trustees will often require a fee agreement to be reached. In the event the Settlor intends to appoint a trust company and a fee agreement is reached, the fee agreement can be incorporated by reference into the trust.

13.7 Liability of Trustees. No Trustee shall be liable for any loss or damage which may happen to the Trust Fund or any part thereof (including without limitation any company or other entity whose shares or ownership interests are comprised in the Trust Fund) or the income thereof at any time from any cause whatsoever unless such loss or damage shall be caused by her or his own actual fraud or gross negligence. A Trustee shall not be liable, answerable or accountable for any loss or damage resulting from the exercise of a discretion or a refusal to exercise a discretion. A Trustee shall be liable, answerable and accountable for her or his own dishonesty or gross negligence. A Trustee is liable, answerable and accountable for money and securities for money actually received by her or him even though she or he has signed a receipt or other instrument for the sake of conformity. A Trustee is not liable, answerable or accountable for the acts, receipts, neglects or defaults of any other Trustee or any other person, firm or corporation having custody of any part of the Trust Fund and is not liable, answerable or accountable for any loss of money or security for money unless the same happens through her or his own dishonesty or gross negligence. Honesty and good faith shall be presumed in favour of each Trustee unless such presumption is rebutted. Every Trustee shall be entitled in the purported exercise of her or his duties and discretions hereunder (including without limitation the management or administration of any company or other entity whose shares or ownership interests are comprised in the Trust Fund) to be indemnified out of the Trust Fund and the income thereof against all expenses and liabilities notwithstanding that such exercise constituted a breach of such Trustee's duties unless brought about by her or his own actual fraud or gross negligence.

The indemnity thereby granted shall be in addition to any and all rights to indemnity by law implied.

13.8 **Corporate Trustee.** Any Trustee hereof that is a corporation may exercise or concur in exercising any discretion or power hereby or by law conferred on the Trustees by a resolution of such corporation or its board of directors or governing body or it may delegate the right and power to exercise or concur in exercising any such discretion or power to any one or more of its directors, officers or employees or to such other person or persons as such Trustee shall think proper.

13.9 **Trustees' Bond.** The Trustees shall not be required to give any bond or security for the due and faithful administration of the Trust Fund or for the discharge of the trusts hereof.

13.10 **Protector.**

Annotation:

This Annotated Discretionary Trust does not include provision for a "Protector", a function more commonly found in international or offshore trust but now also found in domestic trusts, usually in limited form. The possible powers of a "Protector" could include the following (from Renaud, P.J., "Protectors in Domestic Trusts" 2008 ETPJ Vol. 27, p.241 at p.263):

- ***Power to demand an accounting***
- ***Power to remove a trustee***
- ***Power to appoint a new trustee***
- ***Power to appoint additional trustees***
- ***Power to amend the trust in certain instances***

- ***Power to terminate the trust***
- ***Power to vest property indefeasibly in the name of a beneficiary***
- ***Power to add or delete beneficiaries***
- ***Power to appoint investment advisors***
- ***Power to authorize certain transactions contemplated by the trustees***
- ***Power to apply to the court for advice and directions***

Commentary regarding the "Protector" has questioned whether a "Protector" is a fiduciary or the holder of a personal power and whether the courts should subject a "Protector" to the same level of scrutiny and accountability as trustees of a trust (see Goodman, W.D., "Is it Possible for a Settlor to Relieve a Protector of all fiduciary Responsibilities?" in Goodman on Estate Planning, 1998 Vol. VI, No. 4 (Federated Press); Waters, D. W.M., "The Protector: New Wine in Old Bottles" in Trends in Contemporary Trust Law, edited by A.J. Oakley, (Clarendon Press, Oxford) 1996). Catherine Brown and Bernadette Dietrich, "The Hiring and Firing of Trustees"- Personal & Estate Planning, 2008 Vol. 1 #3 (Federated Press)

From an income tax perspective, depending on the identity of the Protector and the powers given to him/her, caution must be exercised to ensure that subsection 75(2) is not triggered.

Conflict of Interest. Notwithstanding trusteeship or anything herein contained, the Trustees are expressly authorized to participate or to continue to participate personally with the Trust Fund in any business or investment activities, whether such activities exist at the date of execution of this Deed of Settlement or arise subsequent thereto, and such Trustee shall not be required to account in any way for any profits made by such Trustee as a result thereof. Without limiting the generality of the foregoing, the Trustees are expressly authorized and empowered to participate or to continue to participate personally in any corporation, partnership or joint venture in which the Trust Fund and such Trustees may have an interest either at the date of execution of this Deed of Settlement or subsequent thereto. The participation referred to in this Paragraph shall not in any way restrict or prohibit any such Trustees from participating on behalf of the Trust Fund in any decisions relating to any such business or investment activities in which such Trustees may have a personal interest. Nothing contained herein, however, shall absolve a Trustee from any obligations to the Trust Fund which such Trustee may have in such Trustee's personal capacity or as partner, co-venturer, shareholder or director.

14. DIRECTORSHIPS, TRUSTEESHIPS OR PARTNERS

14.1 Act as a Director or Trustee. Any Trustee hereof may act as a director, officer or employee of any company whose shares, bonds, debentures, notes or other securities form part of the Trust Fund and may act as a director, officer or employee of any affiliate or subsidiary of any such company, or as a trustee of a trust whose notes or other securities form part of the Trust Fund; and a Trustee who is so acting may retain for himself any remuneration which he may receive as a director, officer or employee of such company, affiliate or subsidiary or as a trustee of such trust notwithstanding that the voting or the withholding of votes or other rights attaching to any shares, bonds, debentures, notes or other securities forming part of the Trust Fund may have been instrumental (either alone or in conjunction with other matters) in procuring or continuing for him any such position or that his qualification for such position may have resulted in whole or in part from the holding of any such shares, bonds, debentures, notes or other securities of the Trust Fund.

It shall not be an obligation of the Trustees or any of them to act as a director, officer or employee of any company in which the whole or any part of the Trust Fund is invested and the Trustees who are not or any Trustee who is not a director or employee of any such company will not be required directly or indirectly to oversee or account for the investment of the Trust Fund or the part thereof that is invested in such company.

14.2 Appoint Other Director or Trustee. The Trustees may appoint such person or persons as they in the exercise of an absolute discretion consider appropriate to act as a director of any company whose shares, bonds, debentures, notes or other securities form part of the Trust Fund or of any affiliate or subsidiary of any such company or as a trustee of a trust whose notes or other securities form part of the Trust Fund and may approve any reasonable remuneration to be paid to any such person or persons. It shall not be an obligation of the Trustees to oversee or be responsible for the acts, decisions or conduct of any such director or trustee.

14.3 Act as a Partner. A Trustee may act as a partner of any partnership with whom the Trust Fund may have any business dealings directly or indirectly, through a company or otherwise, and a Trustee who is so acting may retain for himself any remuneration which he may receive as a partner of such partnership notwithstanding that the Trust Fund or a decision of the Trustees may be instrumental in creating the profits of such partnership or may contribute thereto.

15. AMENDMENT OF DEED OF SETTLEMENT, REMOVAL OF TRUST FUND AND/OR ADMINISTRATION

15.1 Amendment of Deed of Settlement. By unanimous agreement at any time among the Trustees and upon obtaining the written approval of a two-thirds majority of the Adult Beneficiaries who are *sui juris*, then any administrative provision of this Deed of Settlement, which, for greater certainty, shall be exclusive of the provisions of Article 4 may be amended or revoked or additional terms may be added thereto but for greater certainty, in no event shall any amendment whatsoever be made which results in any part of the Trust Fund or any property substituted therefor being paid or lent to or reverting to the Settlor or any person from whom property was received in any manner or circumstances whatsoever.

***Annotation*: See earlier discussion on subsection 75(2).**

***Annotation:* The forgoing clause restricts the ability to amend the trust indenture to amendments of the administrative provisions of the trust indenture.**

If it is desired to provide for a broader power of amendment, it should be noted that there is a risk CRA may consider that there is a deemed disposition of the beneficiary's interest in the trust or a deemed resettlement of the trust depending on the nature and extent of the amendment.

See also Murphy v. R, 1980 CarswellNat 262; [1980] C.T.C. 386; 80 D.T.C. 6314 (FCTD).

15.2 Removal of Trust Fund. The Trustees may at any time and from time to time remove the whole or any part of the Trust Fund and the administration of the Trust Fund from one jurisdiction to another as the Trustees in the exercise of an absolute discretion shall consider advisable and in the best interests of the Beneficiaries.

16. PURCHASE OF LIFE INSURANCE

16.1 Purchase of Life Insurance. The Trustees may in the exercise of an absolute discretion purchase on behalf of the Trust Fund, policies of insurance on or purchase annuities on or in respect of the life or lives of any Beneficiary or on the life of any person in whose life any Beneficiary has an insurable interest. The Trustees may in their absolute discretion determine the class of, kind of and conditions attaching to the insurance or annuity to be purchased. Insurance includes term insurance. The Trustees shall not be held responsible for the form, genuineness, validity, sufficiency or effect of any such policy or annuity or for the act of any person which may render any such policy or annuity null and void or voidable or for the failure of the insurance company or issuing body to make payment upon such policy or annuity when due and payable or for any delay occasioned by reason of any provision contained in any such policy or annuity and the Trustees shall not be held responsible if, for any reason, any such policy or annuity shall lapse or otherwise become unenforceable.

17. ACKNOWLEDGEMENT

17.1 Acknowledgement. It is hereby acknowledged that certain of the Trustees, from time to time, is or may be a principal, officer, director, employee, unitholder and/or shareholder of <*>, or any successor, associated, connected or continuing **[partnership, corporation]** of <*>, and in such capacities may receive remuneration or other benefits from **[<*>]**, and it is also hereby acknowledged that the Trust Fund may directly or indirectly hold units or other interests in **[<*>]**.

17.2 Administration of Trust to Avoid Attribution. Notwithstanding anything in this Deed of Settlement to the contrary, none of the provisions in this Deed of Settlement shall be interpreted or operate so as to give rise to the attribution of income for tax purposes to the Settlor or to any person who has settled property on the Trust Fund or otherwise directly or indirectly transferred property to the Trust. In particular and without limiting the generality of the foregoing, the Trustees shall not exercise any power granted to them in this Deed of Settlement if such exercise may be construed as causing any property of the Trust Fund or property substituted therefor to revert to the person from whom it was directly or indirectly received, for the purposes of subsection 75(2) of the *Income Tax Act*.

18. SITUS AND GOVERNING LAW

18.1 Situs of the Trust Fund. Until changed by resolution of the Trustees, this Trust Fund shall have its *situs* in and be subject to the laws of Ontario.

18.2 Governing Laws. This Deed of Settlement and any question of law relating to the construction of this Deed of Settlement and the administration of the Trust Fund shall be construed in accordance with the laws of the Province of Ontario, Canada, unless the Trustees determine to the contrary in writing, which they are hereby authorised to do.

19. IRREVOCABLE TRUST

19.1 Irrevocable Trust. This Deed of Settlement is intended and is hereby declared to be irrevocable by the Settlor.

20. FAMILY LAW ACT

20.1 No Community of Property

(a) If and to the extent permitted by applicable law, no benefit under this Settlement shall be assigned or anticipated or fall into any community of property or partnership which may exist between any Beneficiary and his or her spouse and every such benefit shall remain the separated property of the Beneficiary free from all rights or controls by his or her spouse.

20.2 Ontario Family Law Act

(a) All property acquired by any Beneficiary under this Settlement including any income or capital of the Trust Fund distributed to such Beneficiary together with any property substituted therefor and any property into which such property can be traced, and all income from and accretion in value of such property, property substituted therefor, property into which such property can be traced, including income on such income, shall be excluded from such Beneficiary's net family property for the purposes of the *Family Law Act*, Revised Statutes of Ontario 1990, chapter F.3, as amended from time to time, and any successor legislation or any similar legislation of any other jurisdiction and, if and to the extent permitted by applicable jurisdiction, will not be subject to claims of ownership or division by such Beneficiary's spouse for the purposes of or pursuant to any family law legislation of any applicable jurisdiction.

21. POWERS – GENERAL

21.1 Powers. The powers granted herein are in addition to all other powers vested in trustees by law or otherwise and without restricting the general powers, discretions and authorities in this Deed of Settlement given to the Trustees, the Trustees shall have the power, discretion and authority to deal with the assets of the Trust Fund (which for purposes of the Settlement shall include assets held in any trust created in the Deed of Settlement), without the interference of any person entitled hereunder.

22. ACCEPTANCE OF TRUST

22.1 Acceptance. By executing these presents, the Trustees hereby accept the trusts herein contained upon the terms and conditions herein provided.

IN WITNESS WHEREOF the parties hereto have executed these presents as at the day and year first above written.

SIGNED, SEALED AND DELIVERED in the presence of:	)		
______________________________	)	______________________________	l/s
Witness	)	**[Name of Settlor]**, Settlor	
______________________________	)	______________________________	l/s
Witness	)	**[Name of Trustee]**, Trustee	
______________________________	)	______________________________	l/s
Witness	)	**[Name of Trustee]**, Trustee	
______________________________	)	______________________________	l/s
Witness	)	**[Name of Trustee]**, Trustee	