HULL & HULL'S
ESTATE, TRUST AND CAPACITY LAW
BREAKFAST SERIES

"Will Drafting Mistakes
Beyond the Basics"

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Will Drafting Mistakes – Beyond the Basics

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1. Discretionary Trusts

A discretionary non-vested trust should be considered when the person creating a trust wants to ensure that the income beneficiary's rights to income and capital during the term of the trust are not vested. As a result, the trustee is given absolute discretion over how much, if any, income or capital is paid for the benefit of the person with a disability.

An essential element in creating a capital discretionary trust is that a person with a disability does not have a vested right to receive either income or capital from the trust.

The *Ontario Disability Support Program Act*, 1997 ("the ODSP") defines those persons who are entitled to governmental benefits because of disability. In general terms, to qualify that person must:

1. have a disability defined by the Act[1];
2. be over 18 years old; and
3. an Ontario resident.

The leading decision in the area is an Ontario case, *The Minister of Community and Social Services vs Henson.*[2] Where the Court held that a discretionary trust

[1] Defined in s. 4(1) of the ODSP as a "substantial physical or mental impairment that is continuous or recurrent and expected to last one year or more; the direct and cumulative effect of the impairment on the person's ability to attend to his or her personal care, function in the community and function in a workplace, results in a substantial restriction in one or more of these activities of

established for a disabled beneficiary would not result in a loss of government benefits by a beneficiary as the beneficiary had no vested right to receive either income or capital from the trust.[3]

The essential ingredients of a discretionary trust are that the trustee have a "mere power" as opposed to a "trust power".[4]

The important components of the discretionary trust in the Henson decision were:

- the trustee had absolute discretion;
- the trust provided that the assets did not vest in the beneficiary;
- the income was to be accumulated and then paid out to the association;
- the trust indicated that the government benefits could be maximized; and
- there was a giftover following the death of the beneficiary.[5]

The drafting of the discretionary trust must be carefully done to enable the trustee to plan distributions from the trust so that the government and other benefits received by the special needs trust individual are not affected.

Attached as a Schedule is a precedent of a Henson trust that may be of some assistance.

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daily living; and the impairment and its likely duration and the restriction in the activities of daily living have been verified by a person with the prescribed qualifications."

[2] (1987), 28 E.T.R. 121, 26 O.A.C. 332 (Div. Ct., affirmed) (1989) 36 E.T.R. 192 (Ont. C.A.).

[3] Note: In Alberta, pursuant to Section 5.4 (2) of the Assured Income for the Severely Handicapped Act, R.S.A. 1980, c. A-48 ("AISH") the Province of Alberta requires special planning considerations. Pursuant to the AISH, the director may deem that an AISH recipient has an interest in the income or capital with fully discretionary trust in certain circumstances.

[4] Kenneth v. Pike, Estate Planning for Families Who Have a Son or Daughter with a Mental Handicapp (1992): The Fundy Regional Council Association for Community Living (at page 87-88).

[5] Ibid, at page 95.

THE ONTARIO DISABILITY SUPPORT PROGRAM ACT, 1997 ("ODSPA")

In 1997 the Province of Ontario brought in the Ontario Disability Support Program Act, 1997[6] ("ODSPA"). The ODSPA superceded the *Family Benefits Act* provisions which related to persons with disabilities.

Part I of the ODSPA deals with eligibility for income support.

The Act provides that an individual is considered to have a disability if he or she has suffered from a continuous or recurrent physical or mental impairment that is substantial in nature and which is expected to last a year or more. The impairment must have a "direct and cumulative effect ... on the person's ability to attend to his or her personal care, function in the community and function in the workplace, results in substantial restriction in one or more of these activities in daily living." Furthermore, the effect on activities of daily living must be verified by "a person with the prescribed qualifications and is typically a member of a health profession that has been approved by the Director of the ODSPA.[7]

Income support under the ODSPA is only available to qualified Ontario residents:

- whose expenses and other budgetary needs exceed their income;
- whose assets do not exceed a base of $5,000.00 for a single person, plus $2,500.00 for a spouse and an additional $500.00 for every non-spouse dependant;
- who provide all required information necessary to determine eligibility;

[6] S.O. 1998, c. 25, see Schedules E, F and G for Statute and Companion Regulations, R.O. 222/98-226/98 and 275/98.

- along with any dependants, meet any other prescribed eligibility conditions;
- the disabled person cannot own more that $5,000 in assets excluding, among other things, "an interest in a trust from an inheritance or from life insurance proceeds to a maximum of $100,000."[8]; and
- with respect to income, the disabled person must not receive gifts or other voluntary payments in excess of $4,000 in any 12 month period[9] and earn more than $160 per month. There are other exceptions, most important of which are payments for disability related items or services which are not included in the income limits[10].

Section 5(2) of the ODSPA provides that income support will be disallowed for a person who is addicted to or otherwise dependent upon alcohol, drugs or other chemically acted substances, unless the individual has a substantial mental or physical impairment.

Part II (sections 19-31) sets out a comprehensive scheme for the review and appeal of income support decisions.

2. When Gifts and Legacies are Considered in Lieu of Compensation

Where a legacy is given to an executor named in the Will, there is a presumption that it was intended as executor's compensation. The onus is on the executor to

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[7] See Section 4 of the ODSPA.
[8] Section 28 of Regulation 222/98.
[9] Section 43(1).13 of Regulation 222/98.
[10] Section 43(1).9 (i) of Regulation 222/98.

rebut that presumption by demonstrating circumstances that show that the legacy was intended in addition to the normal right to executor's compensation.

The general rule is that a legacy appointed to an executor is given to him/her in that character and the burden is on him to show something in the nature of the legacy or other circumstances arising on the Will to repel that presumption. The presumption will be rebutted if it should appear, either from the language of the bequest or from the fair construction of the whole Will, that the bequest to the person who is named as an executor is given to him/her independently of that character.[11]

The description of the executor/ legatee is, in some circumstances, sufficient to rebut the presumption. For example, in *Re Greenaway*[12], the words, "for his own use absolutely" after the legacy to the executor were held to be sufficient to rebut the presumption. In *Re Ross*[13] the following factors were considered relevant:

1. Only 2 of the 3 executors benefit as beneficiaries under the Will;

2. The amounts of the legacies to the executors/beneficiaries are different;

3. The substantial size of the legacies indicate that they are not merely to compensate them for time and effort;

4. There is no reference to "executor and trustee" in the clauses dealing with the legacies to the 2 executors;

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[11] *Re Bassett* (1911), 19 O.W.N. 420 (H.C.).
[12] [1954] 3 D.L.R. 657 (Man. Surr. Ct.).

5. The clause dealing with the legacies to the executors/beneficiaries do not immediately follow upon their appointment as executors; and

6. The reason for the generosity of the legacies is apparent.

The case-law establishes that the presumption that a legacy is intended in place of compensation is relatively easy to rebut.

Furthermore, one should consider the more recent case of *Re Kotowski Estate*[14] where the fact that the legacy is coupled with "some endearing words", the Court held that was sufficient to entitle the executor to the bequest and to reasonable compensation as executor.

In *Re Stanley Estate*[15], the Court considered the reference to the executor/legatee as "trusted friend" and "in her personal capacity". The Court held that such language created sufficient evidence to rebut the presumption.

Calculation of Compensation Generally

The statutory basis for executor's claim for compensation is Section 61 of the *Trustee Act*:

> "A trustee, guardian or personal representative is entitled to such fair and reasonable allowance for the care, pains and trouble, and

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[13] [1976] 3 W.W.R. 465 (B.C.S.C.).
[14] (1987), 22 E.T.R 174 (Man. Q.B.).
[15] (1996), 13 E.T.R (2d) 102 (O.C.G.D.).

> the time expended in and about the estate, as may be allowed by a judge of the Superior Court of Justice."

This provision is applied in the following manner:

The executors are entitled to apply 2.5% on all receipts and 2.5% on all disbursements. The results of this mathematical calculation is then applied against 5 discretionary factors, namely, the following:

(a) The size of the trust;

(b) The care and responsibility involved;

(c) The time occupied in performing the duties;

(d) The skill and ability shown; and

(e) The success resulting from the administration.

The results of this testing process enables a judge to determine whether the claim for compensation is excessive or not and, as a result, will enable the judge to make adjustments as required.

For example, one factor which would support a claim for full compensation at the 2.5% rate would be the Executor's involvement with the negotiation of a sizeable claim against the Estate.

From that compensation, you are generally required to do the following:

1. Deduct the costs of preparing the Estate accounts in Court format for Passing; and

2. Any agent's fees, including payments to lawyers or accountants who perform executor's work, as opposed to legal or accounting work.

As well, executors are not entitled to take compensation until the consent of all of the residuary beneficiaries is obtained or the Court orders such compensation to be taken.

Because of the 5 factors, it is not unusual for there to be a reduction in the "usual percentages" from 2.5% to some lesser percentage depending upon the type of the assets in the Estate and the type of distribution. For example, where there are liquid assets, such as GICs or bank accounts, it is not unusual to receive a lesser percentage for receipts of those items. Similarly, where assets are distributed *in specie* to the beneficiaries without converting them to cash, a reduction on the disbursement side is generally applied.

3. FORFEITURE OF GIFTS IN A WILL

An effective means of dissuading beneficiaries from frivolous or unwarranted challenges to a will is to provide a clause in the will that if its validity is challenged by the beneficiary who receives the gifts, that beneficiary's entitlement to the gift is forfeited.

Such a clause is often referred to as an "in terrorem" clause and is really a condition imposed by the willmaker on the gift.

Such a condition if carefully and properly drawn is legal and enforceable and while it is true that, like all clauses of forfeiture, the courts will construe such a

clause strictly, such clauses must be approached with great care and some trepidation if a challenge to the will is being considered by the beneficiary who receives the gift.

A condition of this nature is particularly effective in avoiding litigation in situations where the willmaker has designated unequal gifts among, say his children, for whatever reason, which gifts are perceived as unfair by one or more of the children, for whatever reason.

If such a gift to a disappointed beneficiary is substantial and meaningful, that beneficiary should be seriously dissuaded form a frivolous or spiteful challenge to the validity of the will if such a clause is included in the will, whereas if it were not present and his gift, in any event of the litigation would be substantial, such a frivolous or spiteful challenge might well be taken.

In preparing such a clause, the draftsman must be careful to limit the condition to challenges to the validity of the will and not to proceedings relating to interpretation or related matters over which the Court has exclusive jurisdiction, otherwise the clause may well be ineffective.

A more comprehensive treatment of this topic is contained in *Canadian Forms of Wills*, Sheard, Hull, Fitzpatrick, Fourth Edition, page 119.

A form for such clause is contained at page 119 of that text as follows:

> "I declare that if any beneficiary of this my Will shall, within ___ years after my death and without the consent in writing of my Trustees, which my Trustees in their discretion may give or

> withhold, institute any action or proceeding in which the validity of this my Will or any Codicil thereto is sought to be impeached, then, in every such case, such beneficiary shall absolutely forfeit and lose all interest in and right to any gift to him hereunder or under any Codicil hereto and every gift so forfeited shall fall into my residuary estate unless it is a gift of a share of my residuary estate, in which case it shall devolve as though such beneficiary had died at the time such action or proceeding was instituted."

Clauses of forfeiture are not illegal or invalid unless it goes so far as to attempt to oust the jurisdiction of the Court to determine questions of construction which it would not normally be held to do; or unless it purports to prevent a legatee from taking proceedings necessary for the protection of his or her rights, in which case it would be repugnant to the bequest.[16]

[16] Canadian Forms of Wills, Sheard Hull Fitzpatrick, 4th Edition, Carswell at page 119, see Feeney on Wills, paragraph 16.61.

Schedule

HENSON TRUST

EMMA SMITH TRUST

THIS TRUST DEED made to be effective as of the day of ,2004.

BETWEEN:

Sam Alter (as Settlor),

OF THE FIRST PART,

-and-

Jane Smith (as Trustee),

OF THE SECOND PART,

WHEREAS pursuant to Minutes of Settlement involving the settlor which Minutes of Settlement have been implemented into a Judgment of The Honourable Justice Jones of the Superior Court of Justice, dated July 12, 2004, Sam Alter is required to settle the sum of $40,000.00 ("the Trust Fund") on trust for the benefit of Emma Smith,

AND WHEREAS the Settlor and the Trustee wish to declare the terms upon which the Trustee has agreed to administer the said Trust for the benefit of the said Beneficiary;

NOW THEREFORE THIS DEED WITHNESSETH THAT the Settlor and the Trustee hereby agree, acknowledge and declare that the Trust Fund, as defined in this Deed, shall be held by the Trustee upon the following trusts:

1. DEFINITIONS

   a. "Alternative Beneficiaries" means those of David Smith, Betty Smith, and Deborah Smith alive at the Distribution Date or the Income Distribution Date as applicable.

   b. "Beneficiary" means Emma Smith ("Emma");

c. "Distribution Date" shall be the date of death of the Beneficiary;

d. "*Income Tax Act*" means the *Income Tax Act* (Canada) and any applicable legislation of any province or other jurisdiction that imposes a tax on income or capital gains;

e. "Person" includes a corporation, trust or partnership as well as an individual;

f. "Trustee" at any time shall mean the person or persons holding office as Trustee of this Trust at such time;

g. "Trust Fund" means any property, including any investments made by the Trustee, that may be held any time by the Trustee pursuant to this Deed and any undistributed income from such property.

Where the plural form is used in this Trust Deed, it includes the singular form, and where the singular form is used, it includes the plural form.

2. SETTLEMENT

By way of settlement for the benefit of the Beneficiary hereinbefore named, the Settlor covenants and agrees to make, and does hereby make, a gift and settlement upon the Trustee of FORTY THOUSAND DOLLARS ($40,000.00) which shall be delivered to the Trustee to be used by her in the manner hereinafter provided, and the Settlor further covenants and agrees that the said gift and settlement of the said $40,000.00 is hereby made irrevocably and absolutely in favour of the Trustee, upon the trusts contained herein. It is agreed that the Settlor shall not have any liabilities or obligations hereunder other than the obligation and covenant to make a gift of $40,000.00 to the Trustee as provided herein.

3. DISTRIBUTION OF CAPITAL AND INCOME UNTIL DISTRIBUTION DATE

Until the Distribution Date the Trustee shall have an unfettered discretion to distribute all or any part of the net annual income and all or any part of the capital of the Trust Fund to or for the benefit of the Beneficiary, at such time or times as the Trustee shall deem advisable or expedient. Any part of the net annual income that is not distributed to the Beneficiary shall be accumulated and shall form part of the capital of the Trust Fund. Provided that if after the expiration of twenty-one (21) years from the date of this Agreement (herein referred to as the "Income Distribution Date") the Trustee is still holding the trust fund, she shall

thenceforth pay to or apply for the benefit of the Beneficiary or her issue or the Alternative Beneficiaries or any of them in such proportions as she may deem appropriate in her absolute discretion, the whole of the net income, if any, derived from the Trust Fund. Notwithstanding the foregoing, the capital of the Trust Fund and the income therefrom shall not vest in the Beneficiary and the only interest she shall have therein shall be the payments actually made to her, or on her behalf, and received by her or for her benefit therefrom.

Without in any way binding the discretion of the Trustee when exercising her discretion in accordance with the provisions of this paragraph, the Trustee shall take such steps as will maximize the benefits which the Beneficiary would receive from other sources if payments from the income and capital of the Trust Fund paid pursuant to this paragraph were not paid to her, or if such payments were limited as to amount or time. In order to maximize such benefits, the Trustee is authorized to make payments varying in amount and at some time or times as the Trustee in the exercise of an absolute discretion considers advisable keeping in mind the comfort and welfare of the Beneficiary a primary consideration.

4. DISTRIBUTION ON TERMINATION OF TRUST

Upon the Distribution Date the Trustee shall distribute the Trust Fund then remaining to or for the benefit of the issue of the Beneficiary, then alive in equal shares *per stirpes*. In the event that the Beneficiary dies leaving no issue, the Trustee shall distribute the Trust Fund, in equal shares to those of the Alternative Beneficiaries who are alive at the Distribution Date. If no Alternative Beneficiaries are alive on the Distribution Date, the Trust Fund shall be distributed among the issue of the alternative Beneficiaries in equal shares *per stirpes*.

5. MINORS

The Trustee may make any distributions of income or capital pursuant to this Deed to any Beneficiary who is under the legal age of majority by distributing the same to a parent or legal or *de facto* guardian of such beneficiary. A receipt given to the Trustee by any such parent or guardian shall be a full discharge of the Trustee with respect to a distribution made to such person. Alternatively, the Trustee may retain and invest the amount or the property otherwise distributed to such Beneficiary until he or she attains the legal age of majority. The Trustee shall have full power and discretion to pay, transfer or apply all of any part of any such amount or property retained by her, or of the income therefrom, to or for the support or benefit of such Beneficiary at any time or times until her or she attains the legal age of majority when such amount or property or the part remaining, if any, shall be paid or transferred to such Beneficiary.

6. POWER OF TRUSTEE

a. **Additions of the Trust Fund**

To accept as an addition to the Trust Fund any gift of money or other property that any person may donate or lend to the Trust at any time or times, either in his or her lifetime or by testamentary disposition;

b. **Investments**

To invest and reinvest any money forming part of the Trust Fund in any investments of any kind whatever without being limited to investments authorized by law for a Trustee;

c. **Acquisition of other Property**

To purchase or otherwise acquire and hold as part of the Trust Fund any real or personal property whether such property is or is not capable of producing income;

d. **Disposition of Trust Property**

To sell, assign, exchange, lease, grant any option or otherwise dispose of the whole or any part of the Trust Fund in any manner for such consideration and on such terms and conditions as the Trustee may deem advisable or expedient;

e. **Borrowing**

To borrow funds from any bank, trust company or other financial institution, person or source, including the Settlor or the Trustee, on such terms and conditions as the Trustee may deem advisable or expedient;

f. **Pledge**

To pledge, charge, mortgage or give any other forms of security on all or any part of the Trust Fund and to renew any such security on such terms and conditions as the Trustee may deem advisable or expedient;

g. **Insurance**

To purchase or otherwise acquire any policy of insurance on the life of any person, to pay any premiums falling due under such policy and to deal

with such policy and any proceeds thereof as part of the Trust Fund in such manner as the Trustee may deem advisable or expedient;

h. **Rights Incidental to Ownership**

To exercise any voting rights and other rights incidental to the ownership of any investments or other property included in the Trust Fund, to grant proxies and to participate in any plan or arrangement for the dissolution, merger or reorganization of any corporation or partnership whose shares, bonds, interests or securities are included in the Trust Fund and generally to do any act with respect to the investments or other property included in the Trust Fund that would be within her power if she were the absolute owner of such investments or other property;

i. **Agreements**

To enter into any agreement or other transaction with respect to any investments or other property included in the Trust Fund upon such terms and conditions as the Trustee may deem advisable or expedient;

j. **Settlement of Claims**

To settle, waive, release or compromise any claim or obligation of her, or owing to her, in her capacity as Trustee;

k. **Limited Liability**

To exclude her personal liability in any agreement or other transaction entered into by her in the course of the management of the Trust Fund or the administration of the trusts under this Deed;

l. **Professional Advice**

To act on information or advice obtained from any lawyer, accountant, valuer, broker, firm of investment dealers or any members thereof or any other adviser or expert and to pay for such information or advice out of the Trust Fund or out of the income therefrom as the Trustee may deem appropriate;

m. **Cash Deposits**

To deposit any money included in the Trust Fund with any chartered bank, duly registered trust company or financial institution in any jurisdiction.

Incorporation

To incorporate, or join with any other person or persons in the incorporation of any corporation and to sell or exchange any property included in the Trust Fund to any such corporation for securities of such corporation or for such other consideration as the Trustee shall deem advisable.

n. **Distribution**

To distribute any part of the Trust Funds in cash to the Beneficiary for such purpose as to determine conclusively the value of any property included in the Trust Fund;

o. **Signing Authority**

To appoint any other person or persons to sign all or any 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 Trust at any time;

p. **Documents of Title**

To hold securities in bearer from or duly endorsed for transfer in blank or to record or register the ownership of any securities or other investments or property included in the Trust Funds in the name of the Trustee or of any agent or nominee of the Trustee and to grant custody of any such securities, investments or property, or the documents of title relating thereto, to any agent or nominee of the Trustee;

q. **Income Tax**

To perform all of her obligations and to exercise all of her powers under the *Income Tax Act* to the extent that they may deem advisable or expedient and, in connection with any elections pursuant to the *Income Tax Act*, as amended, or any other determinations or designations to be made by the Beneficiary, to accept as valid and binding any such election or designation that purports to be made by any legal or de facto guardian on behalf of such Beneficiary; and

r. Agents

To appoint any person or persons to act as her agent and to delegate in writing to such agent all or any of the powers conferred upon the Trustee

under this paragraph 6 including, for greater certainty, the power to make and change investments on behalf of the Trust.

7. APPOINTMENT OF NEW TRUSTEE

In the event that the Trustee becomes unable or unwilling to act as Trustee, the Trustee may appoint a successor Trustee or Trustees to replace her. In the event that the Trustee dies or becomes incapable and has appointed an Executor or an Attorney under a General and Enduring Power of Attorney for Property, the Trustee's Executor, or Attorney, as the case may be, shall automatically become the successor Trustee. If the Trustee fails to appoint a successor, the Court may, on application of the Beneficiary or any Alternate Beneficiary, appoint a replacement Trustee.

8. LIABILITY OF TRUSTEE

All powers conferred upon the Trustee or upon her agents pursuant to this Deed shall be exercisable in the unfettered discretion of the Trustee or such agents, as the case may be, and no Trustee or agents acting honestly, in good faith and for the benefit of the Beneficiary, shall be liable for any act or omission in the purported exercise of any such power or in the performance of her obligations pursuant to this Deed or for any loss or diminution in value suffered by the Trust Fund unless such act, omission, loss or diminution in value constitutes, or is caused by, dishonesty, gross negligence or willful default of such Trustee or agents as the case may be. The Trustee shall, in regard to all powers, authorities and discretion vested in her by this trust agreement have absolute and uncontrolled discretion in the exercise thereof whether in relation to the manner or to the mode of such exercise and the Trustee, acting in good faith, shall in no way be responsible for any loss, costs, damages or inconveniences that may result to the Trust Fund or to any of the beneficiaries of the trusts hereby created from the exercise or non-exercise of any such power, authority or discretion. The Trustee shall exercise the powers and discretion given to or, conferred upon her in what she deems to be the best interests, whether monetary or otherwise, of the Trust Fund and/or of the Beneficiary of the trusts hereby created, and all such exercise of her powers and discretion shall be binding upon the Beneficiary of the trusts hereby created and shall not be subject to any question by any question by any person, official, authority, Court of tribunal. The Trustee shall be chargeable with the answerable only for her own gross neglect or willful default and shall be indemnified out of the Trust Fund in respect of all liabilities which she may incur in the execution of the trusts hereunder or in the exercise of the powers and/or discretion herein given the Trustee saving always any such liability (if any) as may arise as a consequence of her own gross neglect or willful default.

9. TRUST IRREVOCABLE

This Trust is irrevocable.

10. DESIGNATION OF TRUST

This Settlement is designated the EMMA SMITH TRUST and the Trustee and her agents may in that name hold title to any investments or other property included in the Trust Fund, carry out any transactions on behalf of the Trust and enter into any contracts or arrangements or otherwise exercise any of the powers, discretion or authorities conferred upon her in this Deed.

11. ACCEPTANCE

The Trustee accept the trusts under this indenture and agrees to administer the same in accordance with the provisions hereof. In any provision herein is or becomes in contravention of any application law or statute, such provision may be voided or deleted by the Trustee in writing and deemed to be severed from this Trust Deed, provided always that the remaining provisions herein shall continue to be valid and binding and the trust established herein shall continue without such deleted or voided provision.

12. GOVERNING LAW

This indenture shall be governed by and construed according to the laws of the Province of Ontario, Canada.

IN WITNESS WHEREOF the parties have executed this Settlement

SIGNED, SEALED & DELIVERED)
in the presence of:) _____
) (Settlor)
)
)
)
) _____
) (Trustee)

Jordan M. Atin

Gift-Over to Residue

It is quite common to have assets which are held in trust for a number of years after the testator's death with the intention that when they are to be distributed it should be done so in accordance with the residue provisions of the Will.

Example:

The testator wants the home to be given to one child (he has 4 children) to live in for 15 years ("the Sale Date") whereupon it is to be sold and the proceeds are to "form part of the residue".

The Residue provision provides for a division of the residue equally among the 4 kids with gift-over to their issue in the event that any of them predecease the testator.

> "Divide the residue among those of my children who are alive at my death. If any of my children predecease me, but leave issue alive at my death, the share shall be divided among his or her issue in equal shares per stirpes."

Problem:
The problem is that if one of the 4 kids survive the testator and die before the proceeds fall into the estate (15 years later), that child's estate receives the share of proceeds not his issue.

Solution:
Provide that the reference to the testator's date of death should be read as the date the property is sold (or the proceeds received).

The sale proceeds shall form part of the residue to be distributed as such, however, in determining the interest of the residuary beneficiaries in such property governed by this sub-paragraph, any reference to the date of my death in subparagraph ____ shall be deemed to be a reference to the Sale Date.

Payments to Parents for Minors

Historically, drafters included a clause in Wills which permitted the trustee to make "payments" due to a child to that child's parent or guardian.

It was often assumed that this clause permitted the trustee to discharge his or her duties in full by paying the entire minor's share to the parent or guardian.

The Superior Court of Justice in *Hedley v. Grant* did not agree. In that case, the trustee attempted to encroach on the capital and pay each of a number of minor's interest to their respective parents. The Court found that the standard clause did not permit such a payment in full of the minor's share to the parent or guardian.

Example:
Testator wants to provide shares in the residue to her grandchildren to be held in trust until they reach age 18.

Problem:
The trustee of the Will is required to hold those monies in trust for each grandchild for many years. The testator may want to have the grandchild's parent take responsibility for managing the money for their own children.

Solution:
Permit the trustee to pay the entire trust funds to the parent as a successor trustee of those funds.

To make any payment of income or capital or to pay any legacy or residuary interest in part or in whole on behalf of any person under the age of majority or under any disability to a parent or guardian of such person or to any person to whom my Trustee, in his absolute discretion, shall consider it advisable to make such payment or payments, whose receipt shall be a complete and sufficient discharge to my Trustee and who shall be deemed to be a successor Trustee with all of the powers of my Trustee with respect to such funds.

Children Born out of Wedlock Clauses

The law in this area has changed back and forth over many years. Historically, issue who were not born in wedlock were excluded automatically by law from sharing in an estate.

In 1978, "illegitimate" children were recognized equally with children born in wedlock and that continues to be the rule today.

A testator, however, is given the right to exclude children born out of wedlock when choosing beneficiaries. The testator when leaving gifts male's issue, may have concerns regarding the trustee's responsibility to search for all children born out of wedlock[1], that trustee's personal liability and the potential costs associated with the inquiries. As well, the testator may not want issue unknown to the testator to have an interest in his or her estate.

Example:
Testator wants to provide for her children and if the child predeceases, then to that child's issue. Testator does not want people coming out of the woodwork claiming to be the issue of his "playboy" son.

Problem:
The child may have issue who were born out of wedlock with whom the child has no relationship or even no knowledge of. However, one of the other children is in a common law relationship and may eventually have children born out of wedlock who the testator wants to include.

Solution:
Define the issue who the testator wants to exclude, but include those who he may want to include, even though they may not be born yet.

ANY REFERENCE in this my Will or in any codicil hereto 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 a person who comes within that description traced through another person who was born outside marriage, however provided that, any person who is:

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[1] S. 24 *Estates Administration Act.*

a) my issue and where the parent (who is also my issue) of such issue has, in the opinion of my trustee, such opinion to be binding on all concerned, acknowledged that such issue is the natural child or issue of my said issue,

b) who has been legally adopted, or

c) born outside marriage and whose natural parents subsequently marry each other prior to the time when the entitlement of the person claiming through such person has to be determined,

shall be regarded as having been born in lawful wedlock to such child of mine, the adopting parent or the married parents, as the case may be, shall be regarded as having always been born in lawful wedlock.

OR

ANY REFERENCES in this my Will to a "child", "children" or "issue" of a particular person include adopted persons but do not include a person born outside marriage nor a person who comes within the description traced through another person who was born outside marriage unless such person comes within the description by virtue of adoption. Notwithstanding the foregoing, a person born outside of marriage shall be considered to be born within marriage to his or her mother or father, as the case may be, for the purposes of this my Will where the person's mother or father, as the case may be, has, in the unanimous opinion of my Trustees, demonstrated a settled intention to treat the person as his or her child;

HULL & HULL BREAKFAST SEMINAR

THURSDAY, JUNE 17, 2004

WILL DRAFTING MISTAKES, BEYOND THE BASICS

ANNE M. WERKER

1. SPOUSE TRUSTS

The announced topics for my portion of our presentation this morning indicate that I will be talking firstly about "Spousal Trusts." I will be restricting my comments to one necessary feature of a spouse trust -- that only the spouse gets to use income and capital. Through inadvertence the drafter may taint the spouse trust by inserting a boilerplate provision that authorizes the trustees to provide a benefit from the spouse trust to someone other than the spouse. A tainted spouse trust would preclude the rollover and the resulting deferral of tax on accrued capital gains until the death of the second spouse. The tainting could preclude significant savings.

In a recent edition of Deadbeat[1], the newsletter for the Trusts and Estates Section of the CBAO, Jana Steele wrote a brief article about the tainting of a spouse trust by a power given to the Trustees to lend on less than commercial terms and the borrower is not restricted to the spouse. As far as the Canada Revenue Agency is concerned, whether or not this power is actually exercised is not material; the mere power "to lend to anyone other than the spouse for inadequate consideration... would be sufficient to taint the spouse trust." Ms. Steele notes the will drafting implications that arise from CRA's position: "any powers that are granted to the trustees of a spouse trust must be carefully examined to ensure that no-one other than the spouse or common-law partner may receive or otherwise obtain the use of any of the income or capital of the trust."

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[1] Volume 22, No. 3, March 2004

We are all familiar with the requirements for a rollover for tax purposes when property is transferred to a spouse or to a spousal trust, or more accurately described currently as a common-law partner trust because since 2001, common-law partners (including same sex partners) are afforded the same treatment as married spouses and spouses who have cohabited for at least one year or are cohabiting parents of the same child.[2] For convenience only, I will continue to refer to spouse trusts in this article.

There are four conditions that must be satisfied to qualify as testamentary spouse trust[3]:

1. The surviving spouse must be entitled to receive all of the income and no one other than the surviving spouse can receive, use or enjoy income or capital during the spouse's lifetime;
2. The taxpayer must have been resident in Canada immediately prior to his or her death;
3. The trust must be resident in Canada when the assets are transferred; and
4. Assets must vest indefeasibly in the trust within 36 months after the taxpayer's death.

Often, because we do not know what assets will comprise the testator's estate at death, or what the precise needs of the family will be, we will advise the testator to create two trusts in his or her will, a spouse trust and a family trust. The family trust will usually give the trustees discretion to distribute income and capital to the spouse, children, or other issue as the trustees see fit. Assets that have a large accrued gain will be settled on the spouse trust in order to maximize the deferral of tax that results from the rollover. Assets with no accrued gain, such as cash and term deposits, will be settled on the family trust[4].

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[2] Note the difference in the definition of common law spouse for tax purposes and the definition of common law spouse for the purpose of a dependants' relief claim in the *Succession Law Reform Act* or support under the *Family Law Act*.

[3] See section 70(6) of the *Income Tax Act*.

[4] Sometimes assets with an accrued gain will be settled on the family trust in order to offset losses, or absorb personal credits that would otherwise be lost.

In addition, sometimes upon the death of the surviving spouse, second-generation testamentary trusts will be established for the children of the testator to take advantage of the graduated tax rates of testamentary trusts and the potential for income splitting.

It may be desirable to have a clause in a will that gives the trustees the power to lend on non-commercial terms to the beneficiaries of the family trust, or to the beneficiaries of the trusts that are created on the death of the surviving spouse. But this feature will disqualify the spouse trust. How does one neatly solve the problem of providing flexibility to the Trustees in connection with the non-spouse trusts while, at the same time, ensuring that the spouse trust is not tainted?

One solution is to restrict the borrowing provision, in accordance with the circumstances. What follows are two possible amendments to part of Lindsay Histrop's "K.11" clause from "Estate Planning Precedents"[5]:

> [If the non-spouse trusts are subsequent to the spouse trust]
>
> *Upon the death of my spouse, or in the event that my spouse predeceases me,* I AUTHORIZE AND EMPOWER my Trustees to lend such part or parts of my estate upon any security which they may deem sufficient or upon no security whatever, to enter into guarantees or indemnifications for the benefit of the beneficiaries of this my Will and firms or corporations in which my estate or one or more of the beneficiaries of this my Will may have an interest and to give security therefor as my Trustees may in their discretion decide and to renew and keep renewed such guarantees and indemnifications as my Trustees see fit.

[5] K.11 includes a power to lend and a power to borrow. Note that if a testamentary trust *borrows*, CRA may determine that trust no longer qualifies as a testamentary trust because there has been a *contribution* to the trust otherwise than by an individual on or after the individual's death and as a consequence thereof. This potential tainting of a testamentary trust may be an administrative error rather than a drafting error, i.e. the borrowing/contribution must actually occur. The present discussion deals with the tainting of a spouse

[OR if the non-spouse trusts are concurrent with the spouse trust]

> I AUTHORIZE AND EMPOWER my Trustees to lend such part or parts of my estate upon any security which they may deem sufficient or upon no security whatever, to enter into guarantees or indemnifications for the benefit of the beneficiaries of this my Will and firms or corporations in which my estate or one or more of the beneficiaries of this my Will may have an interest and to give security therefor as my Trustees may in their discretion decide and to renew and keep renewed such guarantees and indemnifications as my Trustees see fit *provided that under no circumstances shall the powers or authorities given in this paragraph of my Will be exercised to provide any benefit, use or enjoyment from the income or capital of the spouse trust to anyone other than my spouse during his or her lifetime.*

Another solution is a "notwithstanding clause" in the Will:

> NOTWITHSTANDING ANYTHING to contrary in this my Will, all provisions of this my Will shall be interpreted in such a way that none of the authority, discretion or powers given to my Trustees anywhere in this my Will, shall, during the lifetime of my spouse, X, extend to provide any benefit, use or enjoyment from the income or capital of my estate [the spouse trust] to anyone other than my said spouse.

We need our boilerplate provisions -- they are tried, true and save time and fiddling -- but they should never be inserted blindly. The will drafter may not have to proof them, but

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trust that will occur because of a drafting error that expands the trustees' powers whether or not that power is exercised.

the powers and authorities they confer should be reviewed to ensure that the estate plan is not inadvertently sabotaged.

2. COMPENSATION AGREEMENTS AND MULTIPLE WILLS

My second topic this morning is compensation agreements and multiple wills. The compensation agreements currently in use at the trust companies vary but many use a declining percentage capital receipt and management fee based on the value of the estate assets under administration or managed over time. If the testator executes more than one will to minimize estate administration tax pursuant to *Granovsky*, but the Estate Trustee for all wills is the same, it may be that once the assets subject to the different wills have been collected and realized, that they will be administered together.

Section 104(2) of the *Income Tax Act* will not allow income splitting between two or more testamentary trusts that have been created by separate wills if substantially all of the property of the various trusts has been received from one person and the income from the trusts accrues or will ultimately accrue to the same beneficiary or group of beneficiaries.[6] Accordingly, if the beneficiaries are the same under each will, there would be no tax advantage in the separate administration of trusts pursuant to separate wills once the assets were all collected.[7]

If the trust company's compensation agreement states that the fee will apply to "*assets held in my estate at my death that are to pass under the terms of my Will*" or similar

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[6] This provision does not preclude the separate taxation of trusts that have been established for different children.

[7] The definition of "testamentary trust" in section 108(1) of the *Income Tax Act* refers to a trust that arises as a consequence of the death of an individual other than other than
(*a*) a trust created by a person other than the individual,
(*b*) a trust created after November 12, 1981 if, before the end of the taxation year, property has been contributed to the trust otherwise than by an individual on or after the individual's death and as a consequence thereof...
The combination of multiple testamentary trusts created by the same person would not, therefore, compromise their testamentary status. See also Cullity, Brown Rajan, *Taxation and Estate Planning*, section 3.7. Assuming the trust terms are substantially the same, there would likely be administrative efficiency in combining them.

language, and two separate compensation agreements are executed and attached to the respective wills, it is possible to interpret the compensation agreement so as to lose the advantage of the declining percentage fee. It is the agreement itself that must be amended, and a clarifying provision in the will that incorporates the agreement will not be effective. So check the agreement and ensure that a provision is incorporated for the multiple will situation. For example:

> In the event that the testator has executed multiple wills that name X Trust Company as the Estate Trustee, all aspects of the Capital Receipts Fee, and/or Management and Administration Fees, shall be calculated on the combined value of assets passing pursuant to those wills in which the testator has named X Trust Company in the capacity of Estate Trustee as if the assets had passed pursuant to one will.

3. APPOINTMENT OF SPECIAL OR SUCCESSOR TRUSTEES

Ian has discussed Henson Trusts this morning. This type of trust, like many other continuing trusts rather than outright distributions, may last for a long time. It may be that the testator wants a different person from the executor to be the trustee. In addition, the person chosen as trustee may be the same age as the beneficiary, or older, and it may be important to facilitate a changing of the guard before the incapacity or death of the trustee. The appointment of successor trustees is my last topic this morning.

The *Trustee Act* allows a replacement trustee to be appointed in limited circumstances by the continuing trustee or the personal representatives of the last surviving trustee. It is possible, pursuant to statute (and subject to the trust terms), that if A and B are trustees and both want to resign, that A resigns and B appoints C, and then B resigns and C appoints D. In addition, the sole surviving trustee may appoint a succeeding trustee by will. But there is no recourse under the *Trustee Act* to change a trustee short of a court

order unless there is more than one trustee or the sole trustee dies[8]. A sole trustee may be unwilling to continue, or incapable of continuing, his or her trusteeship long before death, or multiple trustees may want to appoint their replacement jointly, and therefore it is helpful to include a provision to allow an appointment of a succeeding trustee during his, her or their lifetime(s) by an instrument in writing.

An example of an appointment of special trustees follows:

> If my son, X, survives me, my Trustees shall pay or transfer one of such equal shares in trust to my son, Y, and my daughter, Z, as special trustees (in this sub-paragraph referred to as "Trustees for X's Trust")...

An example of a clause that, among other things, enables the appointment of replacement trustees follows:

> The Trustees for X's Trust shall have all the same powers, discretions and authorities as I have given to my Trustees under this my Will. In addition, the Trustees for X's Trust, or the survivor of them, shall have the power of appointing a new Trustee or Trustees for X's Trust, and such power may, from time to time, be exercised by instrument or instruments in writing during their respective lifetimes or by their respective last Will and Testament, or any Codicil thereto, and such power shall extend to the appointment of a new Trustee or new Trustees in the place of any Trustee dying, ceasing to act hereunder or resigning his or her trusteeship and also to the appointment of any additional Trustee or additional Trustees up to any number subject to such limit (if any) as may for the time being be imposed by any governing law. Notices of all changes in the trusteeship of X's Trust shall be signed by the surviving or continuing Trustees and every such notice

[8] See section 3 and 4 of the *Trustee Act*. Note that an executor cannot merely resign but must be removed by court order.

> shall be sufficient evidence to any person having dealings with the Trustees for X's Trust for the time being as to the facts to which it relates.

In the event that the executors and trustees are one and the same (and special trustees are not appointed), the will drafter has to take care when inserting a provision that allows a trustee to appoint their own replacement. The initial appointment of an executor/trustee may provide for a substitute trustee in the event that the first trustee has predeceased the testator or is unable or unwilling to act or to continue to act. It may be that the testator intends to provide for an alternate only in the event that his or her first choice is unable to come to bat, but wishes to delegate to the first-named trustee the power to appoint a replacement if need be. This needs to be clarified when the instructions are given. Does an appointment by the incumbent trustee take precedence over the appointment by the testator, or must the current trustee resign in favour only of the substitute appointed by the testator? In other words, if the testator appoints A as his executor and trustee, and if not A, then B; and the will includes a provision that allows the trustee to appoint his or her own replacement, can A appoint someone other than B, only if B renounces? Is only B authorized to appoint a successor? As with all drafting, clarity of intention in possible permutations is paramount. The following sample clause that gives precedence to the alternate trustee appointed by the testator is not perfect, but a step in the right direction:

> Subject to the appointment of Y that I have made in paragraph # of this my Will in the event that X predeceases me or is unable or unwilling to act or to continue to act as the Estate Trustee, Executor and Trustee of this my Will, my Trustees, or the survivor of them, shall have the power of appointing a new Trustee or Trustees, and such power may, from time to time, be exercised by instrument or instruments in writing during their respective lifetimes or by their respective last Will and Testament, or any Codicil thereto, and such power shall extend to the appointment of a new Trustee or new Trustees in the place of any Trustee dying, ceasing to act hereunder or resigning his or her trusteeship and also to the appointment of any additional Trustee or additional Trustees. Notices of all changes in the

trusteeship of the Trusts herein shall be signed by the surviving or continuing Trustees and every such notice shall be sufficient evidence to any person having dealings with my Trustees for the time being as to the facts to which it relates.

HULL AND HULL BREAKFAST SEMINAR JUNE 17, 2004

CUMMINGS v. CUMMINGS

[2003] O.J. No. 601-Cullity J.

[2004] O.J. No. 90- Ontario Court of Appeal

1968 – Deceased (Cummings) married Wife 1.

1975 – Son Paul born. At date of application (2003) he was severely disabled.

1981 – Daughter Elizabeth born. At date of application in 2003 she had one more year of school left.

1986 – Deceased and wife No. 1 separate.

1988 – Deceased and common law spouse commence common law relationship and common law spouse pays share of matrimonial home payments and other household expenses.

1992 – Deceased and wife 1. divorced and support order made payable to wife 1. for son and daughter.

1994 – Employment of Deceased terminated. Earning $300,000 p/a prior to termination, thereafter virtually no income.

1997 – Deceased and Ruta marry (Wife 2.). Wife 2. pays part of support claim from her funds.

1998 – Deceased makes will appointing Wife 2. as executor and leaving trust fund of $125,000 for children's support obligations.

1998 – Deceased dies survived by Wife 1., Wife 2., son Paul and daughter Elizabeth.

2000 – Wife 1. claims for support on behalf of her two children but makes no claim herself and Wife 2. made no support claim.

2003 – At date of hearing, the net estate both testamentary and notional (after clawbacks pursuant to s.72(1) of the SLRA) and payment of debts and taxes was $650,000, including arrears of support and consisted in part of $220,000 being the deceased's share in the equity in the matrimonial home, contributed in part by Wife 2.

Financial claim of Paul assessed at several millions, far exceeding the total value of the assets of the Deceased.

Judge gave trust fund of $ 250,000 for children to wife 1., $10,000 of which was ear marked for Elizabeth, remainder for Paul's care, $40,000 to Wife 1. for arrears of child support, and in effect gave the Deceased's share in the equity of the matrimonial home to wife 2. on the basis that she had participated rather fully with her financial matrimonial obligations in the marriage.

Any funds left over were to be held for son Paul.

It seems that the main difficulty encountered by the applications judge in not awarding the entire assets, both testamentary and notional, chargeable to satisfy the claims on behalf of the children was that to do so would leave Wife 2. with no interest in the matrimonial home to which she had made substantial contributions as well as having paid part of the support payments due under the court order made on the divorce of the Deceased and Wife 1.

This appeared to ignore the moral duty of the deceased to provide for Wife 2., having regard to her contribution to the relationship.

Prior Ontario decisions held that primary consideration in assessing awards was the economic needs of the dependant and moral considerations were subsidiary thereto. McSween v. McSween (1985), 21 E.T.R. 195.

Applications judge reviewed all prior cases and s. 62(1)(xvi) and dealt with the recent Supreme Court of Canada case of Tataryn v. Tataryn, [1994] 2 S.C.R. 807 and its treatment of moral claims under the Wills Variation Act of British Columbia.

That case held that moral claims under that statute should be considered.

Notwithstanding substantial differences in both the wording and what was generally considered in Ontario to be the thrust of that act, both the applications judge and the Ontario Court of Appeal followed the thinking in the Tataryn case and held that moral claims should be considered by the court in Dependant Support applications under the SLRA.

Consideration must be given to expanding what could be termed moral obligations to provide adequate and proper support under the SLRA.