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Income beneficiaries, capital beneficiaries and the Children's Lawyer, oh my!

In 1980, Primo Poloniato, the founder of Primo Foods Ltd., established a trust in favour of his grandchildren (the income beneficiaries) and their issue, the great-grandchildren (the capital beneficiaries). The trust was settled as part of an estate freeze. Initially, the trust held the growth shares of Primo Foods through a numbered company. On Mr. Poloniato's death, the shares were sold and the proceeds were invested in securities and near cash equivalents held in the holding company. The Trust's principal asset was shares in the holding company. The value of the trust asset fluctuated, but at one point it was worth more than $130 million.

Mr. Poloniato died in 1984. At that time there were seven grandchildren (income beneficiaries) alive. Under the trust provisions, income was to accumulate in the trust for 21 years or up until the death of the first income beneficiary when the trust would be split equally into sub-trusts for each grandchild living or to their issue. The trustee was given no specific power to encroach on capital.

The trust value had grown significantly and the income beneficiaries sought early access to some of the income from the trust to assist them in addressing their immediate financial needs. They also sought to plan for the disposition and distribution out of the trust at the 21 year mark. In December of 1988, the court approved the trust variation whereby there were accelerated payments of income to the income beneficiaries beginning in 1988 and continuing in 2001. The variation was consented to by the trustee, the adult beneficiaries and the Official Guardian (later referred to as the Children's Lawyer), who represented the interest of the minor, unborn and unascertained beneficiaries of the trust.

In 1997, the trust deed was again varied by the court. The variation changed the nature of the trust to a "percentage trust" or a "unitrust." This change would allow the trustee to use a balanced portfolio strategy of investing. The effect of the conversion to a percentage trust was that the income beneficiaries were no longer entitled to receive income from the trust. They would instead receive a fixed amount of money from the trust each year, based on a percentage formula that included mandatory minimum and maximum limits.

In 2002, a market downturn caused the trust to sell capital assets to meet its obligations to the income beneficiaries. The trustee, Canada Trust, obtained a report to determine the life of the trust and its current levels and concluded it was likely to expend within 18 to 20 years. The trustee sought direction from the court as to whether it was required to maintain such distributions or whether it had discretion in this regard. What resulted was a lower court decision that was later appealed by the Children's Lawyer. (see Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne (2012), 2012 CarswellOnt 15402, 2012 ONCA 862).

At trial, the judge determined that the trust deed as varied required the trustee to make the percentage distributions to the income beneficiaries in spite of the downturn in the market and its effect on the capital value of the trust. The variation provided the trustee discretion in respect of the management of distributions of the holding company to the trust. The judge also found that the variations to the trust deed did away with the duty on the trustees' part to maintain an even hand between the income beneficiaries and the capital beneficiaries and that there was never any intention by the parties to restrict the amounts distributed to income beneficiaries from the holding company to the income earned by the company. The judge acknowledged that this conflicted with Mr. Poloniato's original intention, but that was no longer relevant given two previous court variations of the trust that had been done with consent of the beneficiaries.

The Children's Lawyer appealed the trial judge's decision on the basis that the judge ignored basic trust principles including that the approach by the trustee would be at the expense of the capital beneficiaries which included minors, unborn and unascertained beneficiaries. They also argued that the judge failed to take into proper account the factual matrix in interpreting the terms of the trust deed as varied.

The Ontario Court of Appeal did not agree with The Children's Lawyer's position. Nothing in the trial judge's decision contradicted or changed the factual matrix as described when the court approved the variation. The "percentage trust" was a new financial approach to investment and disbursement of trust funds which allowed the trustee to maximize the overall value of the trust assets for all beneficiaries' benefit. The variation was not to benefit the income beneficiaries over the capital beneficiaries. There was consideration by the trial judge as to the impact on the capital beneficiaries. The court found that the trustee's duty was not to obtain a large income yield while preserving capital, but rather to increase the size of the entire trust for the benefit of all.

I wrote about this case because I am often asked about when a trust can be varied. Ultimately, the discussion leads to the involvement of the government or, really, the Children's Lawyer. The case is a good illustration of when the Children's Lawyer may become involved. That office will bring matters to trial that could impact minor, unborn or unascertained beneficiaries.

These columns are current as of the time of writing, but are not updated for subsequent changes in legislation unless specifically noted.

February 2013

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