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Varying Terms of a Trust - Not A Simple Solution

Often clients create a trust as part of their overall estate plan. Whether the trust meets all of the settlor's objectives depends on what happens over time. Varying, or changing, the terms of a trust may be viewed as a simple solution to any issue that may arise, however it is seldom a simple solution. The recent case of Eaton v. Eaton-Kent, 2013 ONSC 7985 (CanLII) reminds of us this fact.

On December 18, 1992 Harold Fishleigh (the "settlor") settled a trust to benefit his children Diana and Wayne. They were to receive the net income from the trust during their lifetime. On the death of the survivor of Wayne and Diana the trust fund was to be divided into two equal shares to benefit each of Diana and Wayne's children, meaning grandchildren and great-grandchildren would be included.

At the time it was drafted and signed, the trust document did not give powers to the trustee to include an ability to encroach on capital before the Trust terminated on the death of Diana and Wayne's survivors.

Pursuant to the 21-year deemed disposition rule applicable to trusts under the Income Tax Act (s. 104(4))a significant capital gain would become taxable in December of 2013.

An application was brought to the Ontario Superior Court to permit the trustees to distribute certain shares to capital beneficiaries to effectively avoid the significant capital gain. In that regard the Trust's accountants had obtained an advanced ruling from to the Canada Revenue Agency (CRA) stating that the proposed reorganization and distributions of the Trust's assets, if approved by the court, would defer taxation of the Trust's assets beyond the December 2013 deadline.

The application was brought on consent of all of the adult beneficiaries of the trust and that of the children's lawyer, who represented minors, unborn contingent beneficiaries. A litigation guardian appointed for one of the adult children who did not have the capacity also consented.

The court confirmed that the variation of a trust will be approved where:

(a) The basic intention of the testator will be kept alive by the proposed variation;
(b) The proposed variation is for the benefit of the minor, unborn, unascertained and incapable beneficiaries; and where
(c) A prudent adult motivated by intelligent self-interest and a sustained consideration of the expectancies and risk of the proposal made, would likely to accept the benefit to be obtained on behalf of those for whom the court is acting.

Having regard to the Applicants' submission and the consent of all the parties the court approved of the variation of the Trust. In the decision the court accepted that Harold Fishleigh settled this Trust in 1992 by making his son and daughter as income beneficiaries for life, with no power to encroach on capital with the capital to be distributed after their death to his grandchildren or their issue. There was an intention to preserve capital for the benefit of the third and fourth generations. Therefore it made sense to the court that the relief sought by the applicants to preserve the capital should be ordered, rather than to have the assets of the Trust depleted by what was referred to in the case as a huge windfall to the CRA.

The case is a good reminder that any time there is a discussion about varying trust terms it is important to remember what the court will consider before granting the variation. If it makes sense and will benefit all of the beneficiaries a variation will be granted but first the court must be convinced.

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