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AN OUNCE OF PREVENTION: MARRIAGE CONTRACTS AND FAMILY TRUSTS

By Margaret E. Rintoul, * *and James B.C. Edney* **

The utility of marriage contracts is often measured in a vacuum; rarely do lawyers and their clients consider the benefits that they can provide in protecting the sanctity of family trusts.

Common parlance has it that marriage contracts are, among other things, unduly provocative, easily set aside by family law courts, and not worth the time, effort and expense they demand.

There's little doubt that challenges to the validity of marriage contracts have been profuse of late. Mere statistics, however, are not in this case particularly revealing. More intense scrutiny, in fact, reveals that the basis for many of these challenges lies in the past, rather than the present.

Historically, marriage contracts were negotiated and prepared at the insistence of the spouse, predominantly the husband-to-be, holding the majority of assets. These agreements were frequently subject to the pressures of time and presented for execution in circumstances that were far from equitable from a bargaining perspective. More often than not, they were characterized by some or all of inadequate financial disclosure, a lack of independent legal advice, and an inequality of bargaining power.

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Too often, an insistent prospective husband or father-in-law would present the contract a day or two before the wedding, accompanied by the direct or implied threat that there would be no wedding unless the contract was signed. Consequently (and rightfully so), the provisions of section 56 of the *Family Law Act*[1] might be triggered many years down the line following the unforeseen and unknowable valuation date also known as the date of separation.

Section 56 provides that a court may set aside a domestic contract if a party did not disclose significant assets; did not understand the nature of the contract; and/or otherwise in accordance with the law of contract.

In short, courts can set aside marriage contracts where one or both parties lack informed consent.

Thankfully, "The Times They are a-Changin".

Today, women (generally, the historically disadvantaged spouse) outpace men in admission to graduate and professional schools. For the most part, parties are much more informed and aware than they have been in the past. Gone is the ubiquity of adamant spouses and docile fiancées entering into marriage contracts unsupported by informed consent.

The *Family Law Act* defines "property" broadly. Trite law now holds that "property" includes interests in the capital and income of a family trust, which is often prepared to address succession concerns for a family business that involves several family members.

In the authors' practice, marriage contracts are often utilized to exclude the capital of a family trust for equalization of net family property purposes. This is particularly so where our client is the beneficiary of the trust as of the date of marriage (as opposed to a trust settled during the marriage, which would be "excluded property" under the *Family Law Act*).

In the Private Client Group at Blaney McMurtry LLP, we have a protocol when acting for clients in the negotiation and preparation of prenuptial agreements. They embrace:

1. Full and frank financial disclosure by way of execution of a sworn financial statement accompanied by supportive financial disclosure brief;
2. Independent legal advice; and
3. A process that must commence sufficiently before the wedding to allow adequate time for the exchange of financial information and several rounds of negotiations (if necessary) prior to execution.

Under these circumstances, with the parties exchanging proposals on a level playing field, including eyes wide open to the fact that the contract excludes an interest in a family trust, a finding of informed consent is almost definitely assured.

[1] R.S.O. 1990, c. F.3.

The upshot is that properly negotiated and executed marriage contracts are the best way to exclude family trusts from forming part of net family property on the date of separation. The Supreme Court of Canada has unequivocally held that parties have wide discretion to include and exclude any property from division, so long as the governing agreement complies with applicable legislation, has been fairly negotiated, and represents the intentions and expectations of the parties.

The recipe used to bake a properly executed domestic contract, then, includes both family and estate planning ingredients. This is particularly evident where the client's (or, more often than not, their parents') objective is the protection of intergenerational family wealth. In such complex circumstances, expertise and experience in the intersection of these two areas of the law is essential. After all, the devil is in the dabble.

UPCOMING AMENDMENTS TO ALBERTA FAMILY LAW LEGISLATION: WHAT THIS MEANS FOR NON-MARRIED COUPLES

By Katrina Wagner[*] and Aaron Vogel[**]

When a married couple divorces in Alberta, each spouse is entitled to a share of their matrimonial property pursuant to the *Matrimonial Property Act*.[1] The legislation provides a framework for dividing matrimonial property between spouses. The court is granted a broad discretion to fashion a matrimonial property order based on a number of factors. Generally speaking, spouses will equally divide most property acquired throughout their marriage. However, spouses have the ability to predetermine their respective entitlements to matrimonial property by entering into a written agreement that provides for the status, ownership and division of that property.

The rights of non-married couples in Alberta is less clear. The *Matrimonial Property Act* only applies to married spouses or former married spouses. Most Canadian common law jurisdictions have enacted legislation to recognize that persons in common-law relationships, similar to those in marriages, are entitled to property division rights upon separation from their partner. Upon the breakdown of a common-law relationship in Alberta, the parties have to rely on complex legal doctrines to establish their respective rights to property acquired during their common-law relationship. This has resulted in little predictability in the division of assets between non-married couples.

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[1] R.S.A. 2000, c. M-8.

However, the legislative regime governing the division of matrimonial property in Alberta will soon change.

Bill 28, the *Family Statutes Amendment Act, 2018*,[2] received royal assent on December 11, 2018 and will become law on January 1, 2020. The *Family Statutes Amendment Act, 2018* contains significant changes to the matrimonial property division legislation in Alberta. The following changes will come into force on January 1, 2020:

- The *Matrimonial Property Act* will be renamed the *Family Property Act*.
- The *Family Property Act* will apply to both married spouses and "adult interdependent partners". Adult interdependent partners are those that meet the criteria in the *Adult Interdependent Relationships Act*.[3] Generally speaking, adult interdependent partners are those who have lived together in an interdependent relationship:
  - for at least three years;
  - in some circumstances, for less than three years if the couple has a child; or
  - who have entered into an adult interdependent partner agreement.
- The *Family Property Act* specifies that the property division rules apply after beginning a relationship of interdependence. Currently, married couples only divide property acquired from the date of marriage. This change ensures that most property acquired throughout the relationship will be subject to the rules in the *Family Property Act*.
- The *Family Property Act* clarifies that married spouses and adult interdependent partners can enter into a property division agreement that applies both during cohabitation before marriage and the time after marriage. If an agreement is entered into before marriage, it will be unenforceable after marriage unless the agreement clearly shows that the parties intended for it to continue to apply after marriage.

While the *Matrimonial Property Act* and the *Family Property Act* contain default rules regarding the division of family property, their application in any given case involves some uncertainty. Couples who wish to divide their property differently than that provided for under the *Matrimonial Property Act* or the *Family Property Act* can do so by entering into a written agreement. The agreement can provide for the fixed distribution of property acquired before, during and after separation.

The *Matrimonial Property Act* contains certain requirements that must be met for an agreement to be enforceable. The *Family Property Act* will apply these same requirements to adult interdependent partners.

If you are contemplating entering into an agreement governing the status, ownership and division of family property, we recommend that you seek the advice of an experienced legal advisor.[4]

2 S.A. 2018, c. 18.
3 S.A. 2002, c. A-4.5.
4 Note: This article is of a general nature only and is not exhaustive of all possible legal rights or remedies. In addition, laws may change over time and should be interpreted only in the context of particular circumstances such that these materials are not intended to be relied upon or taken as legal advice or opinion. Readers should consult a legal professional for specific advice in any particular situation.

PRIVATE COMPANY PROFITS, LOSSES AND DIVIDENDS

By Paula White*

The recent case of *V.O.E. v. L.L.E.*[1] highlights two important issues in determining income for shareholders of private companies:

1. Should corporate losses be attributed to the shareholder?
2. How should dividends from a private company be reflected in income?

The jointly-engaged expert in this case attributed corporate losses to the father, and did not apply a gross-up on dividends received by the father.

The judge in this case notes that:

1. The purpose of the *Federal Child Support Guidelines*[2] (the "Guidelines") is to determine the actual or effective income available to a payor;
2. Section 18 of the Guidelines allows the court to look behind closely-controlled corporations to see if there are undistributed funds in the corporation that are available; and
3. Attributing corporate losses effectively collapses the distinction between corporation and payor as legal entities, which is not the intent of section 18.

Presumably, the rationale for not attributing corporate losses to a shareholder is that the existence of a corporation protects the shareholder from having to fund losses personally. The Guidelines therefore only address corporate *income* and ignore corporate losses.

But are there instances where corporate losses should be considered? We think the answer is yes, in the following circumstances:

1. *Remuneration that is capital, not income.* For example, the company paid a $200,000 salary to the shareholder, but incurred a loss of $100,000. Line 150 income is $200,000. But if no salary had been paid, Line 150 income would be $nil, and the company would have earned a profit of $100,000, which might be attributed to the shareholder as income for support purposes. Clearly, $100,000 is the shareholder's economic profit for the year. The excess $100,000 of salary paid to the shareholder has come from capital, not income.

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1 2018 CarswellAlta 2751 (Alta. Q.B.).
2 SOR/97-175.

2. *Losses funded by the shareholder.* The question of how losses are financed is relevant. In our view, the existence of a corporate structure does not always protect a shareholder from incurring losses personally. We have seen instances where losses have been funded directly by shareholders via shareholder advances, and where external debt is obtained but only with the personal guarantee or postponement of the shareholder.
3. *Where other companies in a group fund the losses.* It is not uncommon for support payors to have interests in more than one private company. It is also not uncommon for the companies to be operationally and/or financially inter-connected, and for some of the companies to generate income while others generate losses. Sometimes profits are moved from one company to another for tax purposes, generating a loss in one company and profits in another. In such instances, it makes economic sense to combine the results of such inter-connected companies together and consider attribution of the net amount. If the net amount of income/losses of the corporate group is a loss, attribution of the net loss should be determined by reference to whether or not the shareholder has personally funded the net loss.
4. *Averaging of income for prospective purposes.* The Guidelines allow for an averaging of income. If a corporation has a history of profitable and non-profitable years, is it fair only to capture profitable years in trying to fix an average income for prospective purposes? If the reason for the losses can be ascribed to events which are not likely to recur in the future, then it makes sense to exclude the losses from the average. But if a company's performance fluctuates due to general market conditions or cyclicality, then including losses in the average may result in a fairer determination of income.

Dividends from Private Companies

Corporate income can be distributed as dividends, but not all dividends are income! Dividends are just the method and timing of distribution of corporate income and equity, and often have nothing to do with the level of income achieved in a particular year. The timing and quantum of dividends is often driven by the cash flow needs of the shareholder and not necessarily the profit of the business.

Dividends declared in a year can be higher or lower than income achieved. Where dividends are higher than income, the source of the excess amount is *capital*, not income. For example, if a corporation earned $200,000 in 2018 and declared no dividends, earned $nil in 2019 and issued a dividend of $200,000, the dividend has come from capital (which includes undistributed income of prior years). The obvious danger is that the $200,000 might be attributed to the payor in 2018 and then included in Line 150 income for 2019, resulting in a double-counting of the same income.

In our view, the better approach is to eliminate private company dividends from income, and then assess whether or not the company's profits for the year are available to the shareholder. This method accurately captures the available income earned in a year, rather than the amount distributed as a dividend.

The payment of dividends is still an important factor to consider as part of a corporate income attribution analysis. For example, if a dividend was paid, it is relevant in assessing the *availability* of income, but not in determining the amount of income. For example, if income for the year is $100,000 and a dividend of $200,000 was paid in the year to the shareholder, then it is obvious that the $100,000 of income was available to the shareholder and should be included in income.

Should Private Company Dividends be Grossed Up?

If the intent of a gross-up is to capture the benefit of a lower tax rate applicable to dividends (versus salary or bonus), then the answer is no, as shareholders of private companies eventually end up paying tax on company profits at the higher rate.

All accountants are aware of the concept of "integration" — the mechanics of the *Income Tax Act*[3] under which corporate profits are taxed at approximately the same rates on employment income no matter if paid as salary, bonus or dividends. Integration is not perfect and there might be some leakage, but a gross-up using standard tax rates for dividends and employment income grossly overstates the benefit, if any.

The following examples illustrate the point (*i.e.*, the effective tax rate on employment income is 24% versus 25.63% on combined corporate tax and personal tax on dividends):

Effective Tax Rate on Corporate Income Paid as Dividend versus Employment Income ($)

		Dividend		Employment Income	
Pre-tax income before mgt bonus		A	100,000	A	100,000
Profit paid as employment income		B	-	B	100,000
Less: personal tax @	24.00%		n/a	C = 24%*B	24,000
Corporate tax @	12.5%	D= 12.5%*A	12,500		n/a
After-tax income paid as dividend		E= A-D	87,500		n/a
Personal dividend tax @	15.0%	F= 15%*E	13,125		n/a
Net cash after tax		G = E-F	74,375	G = B-C	76,000
Total tax paid		H = D+ F	25,625	H = C	24,000
Effective tax rate		**I = H/A*100**	**25.63%**	**I = H/A*100**	**24.00%**

Note: personal tax rates are rounded, approximate rates.

[3] R.S.C. 1985, c. 1 (5th Supp.).

GUIDANCE PROVIDED BY MINISTRY OF FINANCE IN RESPECT OF MULTIPLE WILLS

By Suzana Popovic-Montag and Nick Esterbauer*

Estate Administration Taxes

Ontario is notorious for its high estate administration taxes. While the provincial government's most recent budget provides some relief in respect of this burden (increasing the size of estates that are exempt from payment

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of estate administration tax to those valued at $50,000 or less), planning to minimize or avoid estate administration tax remains a primary estate-planning concern for many Ontario residents.

Multiple Will Planning

A common and effective mechanism for limiting exposure to estate administration taxes is the use of multiple wills to reduce the assets to be administered under the probated will. Typically, a primary last will and testament covers only those assets for which probate is required, often including real property, while a secondary will addresses the disposition of all other assets.

Re Milne Estate

Prior to its successful appeal, *Re Milne Estate*,[1] was a source of concern for estate planners throughout the province. The decision raised the issue of the validity of multiple wills on the basis of their use of discretionary allocation clauses, which eliminate the "certainty of subject matter" required for a valid trust. The lower court's determination was made on the basis that a will is a trust in respect of which the three-certainties test applies.

In *Re Milne Estate*[2] the Divisional Court clarified that discretionary allocation clauses are not fatal to the validity of a will (at para. 24):

> The fact that an allocation clause is discretionary does not mean that the power conferred by it can be exercised arbitrarily. The power of an executor to allocate must be exercised in accordance with the standards of applicable fiduciary duty.

The court recognized the impracticality of providing a definitive list of assets for which a Certificate of Appointment of Estate Trustee With a Will may or may not be required by the time of the testator's death, often years after the preparation and execution of primary and secondary wills.

The Divisional Court reviewed the issue of whether a will was, as Justice Dunphy of the Superior Court of Justice had suggested, a trust. While a will may give rise to the creation of one or more testamentary trusts, a will itself is not a trust and, accordingly, the three certainties need not be satisfied in order for the will to be valid. To be valid, a will must instead comply with the formal requirements outlined within the *Succession Law Reform Act*.[3]

Aftermath of *Re Milne Estate*

While the Divisional Court's decision in *Re Milne Estate* supported the use of a discretionary allocation of assets between primary and secondary wills based on a determination by the estate trustee for the need of probate, some uncertainty remained in respect of how far trustee discretion could go and how best to prepare multiple wills without unnecessarily exposing assets to estate administration tax.

Consider, for example, discretionary allocation clauses worded as follows:

> Primary Will:
> This Will applies to any assets for which my Trustees determine a grant of authority by a court of competent jurisdiction is required for the transfer or realization thereof.
>
> Secondary Will:
> This Will applies to any assets for which my Trustees determine a grant of authority by a court of competent jurisdiction is not required for the transfer or realization thereof.

Prior to the testator's death and the estate trustee's determination as to which assets require probate, it cannot be determined in respect of some assets whether they will fall under the primary or secondary will. As a result, drafting solicitors may want to include dispositive clauses dealing with specific assets within both documents. For example:

> Primary Will:
> To the extent that this asset is governed by my Primary Will, I direct my Trustees to transfer [my house] . . .
>
> Secondary Will:
> To the extent that this asset is governed by my Secondary Will, I direct my Trustees to transfer [my house] . . .

However, until very recently, it was unclear whether such wording appearing in both wills would expose an estate to estate administration tax in respect of assets identified within a primary will (but being administered under the secondary will) and/or whether these assets would need to be included in the Estate Information Return.

Recent Guidance Provided by the Ministry of Finance

In response to the above scenario and proposed wording for primary and secondary wills, the Ministry of Finance has shared the following position:

> The responsibility for determining whether an asset requires an estate certificate to transfer it rests with the estate representative. The estate representative would therefore, in the case described above, make a determination as to whether the "house" requires a grant of authority in order to transfer it based upon objective criterion.
>
> If the estate representative determines that an estate certificate is not required for the purpose of transferring the house, this asset would be excluded from the Estate Information Return. Please note that pursuant to the Minister's power of audit and inspection under section 4.7 of the *Estate Administration Tax Act, 1998*,[4] the Minister may request, among other things, information, documents and records relating to the determination.

This clarification provides meaningful guidance to estate lawyers in assisting clients to create estate plans in a manner that reflects both a client's testamentary intentions and minimizes probate-related estate expenses.

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1 2018 CarswellOnt 15063, 2018 ONSC 4174 (Ont. S.C.J.).
2 2019 CarswellOnt 843, 2019 ONSC 579 (Ont. Div. Ct.).
3 R.S.O. 1990, c. S.26.

4 S.O. 1998, c. 34, Sched.

CHANGES TO PROBATE TAX: WHAT TO DO WITH YOUR NEW-FOUND $250?

By Danna Fichtenbaum*

Adding to the anticipated 2018-2019 deficit, Doug Ford's provincial government has provided a $250 tax break to estates which will be probated on or after January 1, 2020.[1] The legislation responsible for these changes is the *Estate Administration Tax Act, 1998*.[2]

On applications for probate,[3] probate tax[4] is owed by the estate at issue. This tax is calculated on the basis of the value of the assets being probated.

If a probate application is commenced prior to January 1, 2020, the tax rates are as follows:

- $5 for each $1,000, or part thereof, of the first $50,000 of the value of the estate; and
- $15 for each $1,000, or part thereof, of the value of the estate exceeding $50,000.

By way of example, a $1 million estate, if submitted for probate before the new year, would pay $14,500 in probate tax to the Minister of Finance, as follows:

- $5 per thousand for the first $50,000 of the value of the estate = $250; and
- $15 per thousand for the remaining $950,000 of the value of the estate = $14,250.

If submitted for probate after the new year, the probate tax owing for the same estate would only be $14,250 (there is no "charge" for the first $50,000 of assets, but the tax on the balance of the value of the estate remains unchanged).

Probate tax owing on estates valued at $50,000 or less would be zero.[5]

Ford's 2019 Ontario Budget Speech claimed that this tax break, among others, puts "people first by making life more affordable and convenient." The extent to which a savings of $250 in the hands of an estate impacts the affordability of life is, of course, yet to be seen.

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1 The maximum tax break of $250 only applies to estates valued at more than $50,000. The savings apply incrementally to estates valued at $50,000 or less.

2 S.O. 1998, c. 34.

3 Technically referred to as "Applications for Certificates of Appointment of Estate Trustee."

4 Technically referred to as "Estate Administration Tax."

5 It is important to note that these "exempt" estates will still be required to file an Estate Information Return in the ordinary course, though the deadlines for such filings will be extended, also in the new year.

COURT OF APPEAL REFUSES LEAVE TO APPEAL COSTS AWARD WHICH OVERSHADOWED AMOUNT IN ISSUE

By Ken Prehogan*

In *Knight v. Knight*,[1] the Court of Appeal released Reasons for Decision refusing to grant leave to appeal from an award of costs of $490,000 plus HST following a 13-day trial arising out of "hard fought — and expensive — matrimonial litigation". This amount far overshadowed the amount in issue. More than half was for a disbursement for an accounting expert. The court stated:

> The trial judge was cognizant that the costs award was high for a 13-day trial. However, the trial judge placed the blame entirely at the feet of the appellant, whose approach to the litigation he characterized as unreasonable: "[the appellant's] tactics coupled with his unacceptable offers to settle, leads me to conclude that his goal was to ensure that [the respondent] suffer a considerable financial defeat even if she enjoyed success at trial."

As for the disbursement for the respondent's accounting expert, the court noted that much of the amount was for chasing disclosure, a significant problem for the respondent.

Section 133(b) of the *Courts of Justice Act*[2] states that a discretionary order for costs may not be appealed without leave. Leave will not be granted unless there are strong grounds upon which the appellate court could find that the trial judge had erred in the exercise of his or her discretion. The appellate court should only set aside the costs order if the trial judge made an error in principle or if the costs award is plainly wrong.

Neither happened here. The appellant sought to have the Court of Appeal perform a line-by-line analysis which was not pursued at trial and which the Court of Appeal declined to do given that the trial judge's costs endorsement did not reveal an error in principle or an error in the exercise of his discretion. To the extent that the appellant based his appeal on the principle of proportionality, the court accepted the trial judge's explanation that the costs award was necessary to defeat what he perceived to be the appellant's tactic of ensuring that the respondent would not benefit from her success in the litigation. The Court of Appeal refused to "second-guess" the quantum of the award.

This case is a caution for the unreasonably aggressive litigant, who should expect to pay an amount disproportionately high compared to the amount in issue and, needless to say, in addition to his or her own legal costs. Counsel are well-advised to make every effort to rein in clients who instruct them to conduct litigation outside the

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1 2019 ONCA 538 (Ont. C.A.).

2 R.S.O. 1990, c. C.43.

norms of acceptable conduct. In some cases, counsel would be well-advised to withdraw from the matter, rather than risk the possibility of a cost award against him or her personally, pursuant to Rule 57.07.[3]

[3] *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194.

HEADS UP ON CROSS-BORDER PROBATE

By Marly Peikes*

With increased mobility, it is becoming more common to have assets in several jurisdictions, and therefore more important to create a comprehensive estate plan that considers all of your assets and not just the assets located where you live. To deal with assets in more than one jurisdiction, there are a number of advantages in having multijurisdictional or separate situs wills.

This article focuses on what happens when a person dies leaving assets in more than one jurisdiction and only one will. If the testator has worldwide assets (including some in Ontario) and a will in his or her home jurisdiction which has been probated there and no separate will in Ontario, the executor will most likely need to apply to the court in Ontario to have the will probated in Ontario as well. Without a local court appointment, the executor will not have authority to administer any interest in Ontario real property or other Ontario assets (the process will be different if the testator was domiciled in Ontario and has assets elsewhere).

The executor will either have to apply to an Ontario court for a Certificate of Ancillary Appointment of Estate Trustee or Confirmation by Resealing of Appointment of Estate Trustee (collectively referred to as an "ancillary court appointment"), which differ based on whether the testator was domiciled in a Commonwealth jurisdiction. Where the original probate was granted in a Commonwealth jurisdiction, resealing may be available from an Ontario court to confirm an executor's authority to act, in a simplified process.

Here are some cautionary issues to consider, which will add additional cost, time and nuisance for your executors:

The wait time to receive a grant of probate is currently five to eight months in Toronto. This timeline will be further extended if the executor needs to first probate the will in the home jurisdiction court before subsequently probating the will in Ontario (or vice versa).

Problems may also arise if the original will is retained by a foreign court or by certain public repositories for wills in foreign jurisdictions, but no probate grant is issued or available. The original will generally needs to be filed with an original application for a court appointment. The executor may need to apply to the Ontario court for proof in solemn form so that a notarial copy of the will may be submitted with the application for a court appointment in the place of the original, where the original is not available.

An executor applying for an ancillary court appointment who is not an Ontario resident or resident elsewhere in the Commonwealth is required to give security (or a bond) to the court. According to legislation, the amount of the bond is double the value of the Ontario assets, but may be reduced or dispensed with at the court's discretion. If there are any minor or incapable beneficiaries, the executor may not be able to get this requirement waived by the court, although some part of the amount may be reduced in appropriate circumstances.

Dealing with an estate with global assets requires specialized assistance from a cross-border legal advisor. With proper advice and planning, these issues can be minimized by preparing a comprehensive plan to ensure the estate can be efficiently administered across borders and assist with any complications that arise.

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