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Highlights

ENHANCING CANADIAN TRUSTS THROUGH INTERNATIONAL TRUST TOOLS

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Botsford and Brandts-Giesen start with a discussion of trust planning, including some key tax challenges and other considerations. The authors then move on to explore aspects of international trust law tools that can enhance Canadian trusts by focusing primarily on the context of planning for probate minimization and wealth preservation.

GIFTS OF ECOLOGICALLY SENSITIVE LAND FOR TAX PLANNING PURPOSES

Gwenyth Stadig, Gowling WLG, & Sarah Hallman-Krul, Miller Thomson LLP

In this article, Stadig and Hallman-Krul discuss the federal Ecological Gifts Program, which provides a way for Canadians who hold ecologically sensitive land to simultaneously protect nature for future generations and attract favourable tax consequences. The authors discuss the benefits and process of donating ecologically sensitive property by means of *inter vivos* and testamentary gifts, highlighting the intricacies of the process and the importance of obtaining proper tax and legal advice.

ENHANCING CANADIAN TRUSTS THROUGH INTERNATIONAL TRUST TOOLS

Blair L. Botsford[1] and Henry Brandts-Giesen[2]

Trusts have been a staple planning tool in Canada for many years as they are flexible vehicles that lend themselves to a variety of circumstances such as:

- planning for minors, vulnerable persons, spouses, and other financial dependants;
- disability planning;
- estate simplification and probate planning;
- and asset protection and wealth preservation.

However, Canadian trust law alone does not always offer optimal solutions to address client goals and concerns. After a discussion of trust planning, including some key tax and other considerations, this article explores aspects of international trust law tools that can enhance Canadian trusts by focusing primarily on the context of planning for probate minimization and wealth preservation purposes.

Probate as a Motivator

Several jurisdictions in Canada, such as Ontario, have what many perceive to be a high rate of estate administration tax or probate fees (e.g., Ontario charges 1.5% on estate values in excess of $50,000 or $15,000 per million). In addition, the processing time for probate applications in some jurisdictions has significantly lengthened in past years. As an example, from the time of filing it can take five to nine months in Toronto, Ontario. Outside Toronto, clients can expect to wait anywhere from two weeks to four months typically.

Probate applications are public with financial information, beneficiary names and addresses, and a copy of the Will forming part of the public record. In addition, a complete copy of the probate application is sent to all the beneficiaries. In some families, there may have been an estrangement with some beneficiaries not wanting their relatives to have contact information, but the current process requires everyone's information to be recorded in the common form rather than separate materials being provided for each beneficiary. This raises privacy concerns and possibly even safety considerations.

Most clients do not want the administration of their estate to be complicated, lengthy or expensive. As a result, they seek alternatives to disposing of their assets through a Will that will require probate and all of its attendant consequences. A popular strategy is joint ownership of assets, but this has limited use due to the presumption of resulting trust[3] and can cause more problems than it solves.

Other options are beneficiary designations and the appointment of successor owners or annuitants on applicable forms of insurance policies or plans. However, when this strategy is deployed, the proceeds are not governed by the testator's Will, which can lead to liquidity issues for the estate, inconsistency in alternative dispositions between plans and the Will, and no trust for minors or insufficiently robust trusts for minors. Once you factor in the possible need to equalize the overall assets of the deceased between beneficiaries by methods such as hotchpot, it becomes a complex matrix to coordinate without error or misunderstanding regarding testator intentions.

What is a client to do? If only there was a flexible vehicle that could consolidate assets and capture the overall vision for wealth preservation and distribution during life and on death. Trusts can be this ideal vehicle for achieving various client goals, although there can sometimes be an intricate web of tax rules to navigate that multiply with the number of jurisdictions involved in a particular client scenario.

Tax Challenges When Engaging in Trust Planning

The first tax challenge is the deemed disposition by the transferor on a transfer of property to most forms of *inter vivos* trusts,[4] which can have a significant cost depending on the amount of the capital gain and the applicable marginal tax rates for the individual. The next challenge is that, depending on the relationship between the settlor/transferor, trustees and beneficiaries, various tax attribution rules can apply such that income, gains, and losses are taxed in the hands of the settlor/transferor instead of the trust or beneficiaries to whom income is paid or made payable from the trust. A particularly pernicious attribution rule is section 75(2) of the *Income Tax Act* (Canada) ("ITA") which, if triggered even for a day, can prevent the rollout of property to Canadian resident beneficiaries thereby defeating an important goal of many clients. Section 75(2) of the ITA provides:

> **75(2)** If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition
>
> - **(a)** that it or property substituted therefor may
> - **(i)** revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as "the person"), or
> - **(ii)** pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
> - **(b)** that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,
>
> any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.

A further Canadian tax-planning obstacle is the 21-year deemed disposition rule whereby discretionary trusts[5] to which the rule applies are subject to a notional sale every 21 years. Depending on the nature of the property held in the trust, this rule can pose liquidity problems and frustrate overall objectives for a particular trust. In some instances, trustees are faced with the proverbial rock and hard place of: (1) trying to find a way to fund the taxes owing from the deemed disposition; or (2) transferring out the property to beneficiaries ahead of the 21st anniversary even though this may not be ideal in the circumstances (for example, because such transfer will put the property at risk or because the beneficiaries may not be ready to receive and manage substantial wealth).

Finally, the form of trust property may create challenges. For example: (1) some family wealth may be in the form of active private companies intended to be maintained across several generations and the 21-year rule may be at odds with respect to corporate succession planning; or, (2) there can be real property that certain

family members wish to claim as their principal residence but, unfortunately, family trusts can no longer hold real property that is intended to be claimed as a principal residence.

All trust planning requires careful consideration and may require compromise between competing goals, but there is a class of trusts that can be used to simplify asset management and estate administration without running afoul of the above issues. This class of trusts is referred to as "self-benefit" trusts and the primary examples are alter ego and joint partner trusts.

"Self-Benefit" Trusts

With "self-benefit" trusts such as alter ego and joint partner trusts, the transferor is entitled to roll property into the trust without triggering a deemed disposition and the 21-year deemed disposition rule does not apply either. Instead, the first disposition of the trust property is deferred until the death of the settlor in the case of an alter ego trust and the death of the last to die of the spouses in the case of a joint partner trust.

An added benefit of alter ego and joint partner trusts is that they can hold real property for which the principal residence exemption is claimed, as well as other real property such as a cottage or rental properties.

Self-benefit trusts do not offer the ability to split income or multiply the capital gains exemption, and they are subject to attribution rules so that all income, gains or losses are taxed in the hands of the settlor(s). As a result, clients are left in the same tax position as if they still retained legal ownership of the property. They are no worse off and, as comments below will demonstrate, they gain several advantages, including:

1. Ease of asset management through consolidation;

2. Asset protection; and

3. Generally speaking, no requirement for probate, which means fewer delays and no estate administration tax exposure where the assets in the trust are concerned.

Ownership of Real Property by Trust – Challenges and Considerations

While the statement above regarding no probate being required should hold true with respect to all forms of property held in a trust, including an alter ego or joint partner trust, administrative policies implemented in Ontario in recent years regarding legal title of real property held in trust has created challenges for trust structuring. These policies have opened up the possibility of exposure to the probate process and the attendant estate administration tax, despite the real property being a trust asset. The difficulty created by the administrative policies stems from the interpretation of certain provisions in Ontario's *Land Titles Act*[6] ("LTA"). The relevant portions of the LTA for this discussion are as follows:

> Trusts not to be entered
>
> 62 (1) A notice of an express, implied or constructive trust shall not be entered on the register or received for registration.
>
> [*Emphasis added*.]

Description of owner as a trustee

(2) Describing the owner of freehold or leasehold land or of a charge as a trustee, whether the beneficiary or object of the trust is or is not mentioned, shall be deemed not to be a notice of a trust within the meaning of this section, nor shall such description impose upon any person dealing with the owner the duty of making any inquiry as to the power of the owner in respect of the land or charge or the money secured by the charge, or otherwise, but, subject to the registration of any caution or inhibition, the owner may deal with the land or charge as if such description had not been inserted.

[*Emphasis added*.]

Owners described as trustees to be joint tenants

(3) Where two or more owners are described as trustees, the property shall be held to be vested in them as joint tenants unless the contrary is expressly stated.

Saving

(4) Nothing in this section prevents the registration of a charge given for the purpose of securing bonds or debentures of a corporation, but the registration of such a charge is not a guarantee that the steps necessary to render the charge valid have been duly taken.

Nature of title of registered fiduciary owners

63 Any person registered in the place of a deceased owner or to whom a patent is issued as executor administrator or estate trustee or in any representative capacity shall hold the land or charge, in respect of which the person is registered, upon the trusts and for the purposes to which the same is applicable by law and subject to any unregistered estates, rights, interests or equities subject to which the deceased owner held the same, but otherwise in all respects, and in particular as respects any registered dealings with such land or charge, the person shall be in the same position as if the person had taken the land or charge under a transfer for a valuable consideration.

Registration of certain trustees

Registration of trustees under Religious Organizations' Lands Act

64 (1) Where registered land or an interest therein is acquired by trustees under the Religious Organizations' Lands Act, it shall be registered in the name of the religious organization without setting out the purposes or trusts on which the land or interest is held.

Registration of other trustees

(2) A person who has been appointed as a trustee under the Bankruptcy and Insolvency Act (Canada) or under any other Act of Canada or Ontario or by the court, upon proof of entitlement satisfactory to the land registrar, may be registered as the owner of registered land or of an interest therein, and the person may transfer the same upon proof of compliance with the Act or order under which the person was appointed.

> Trustees of pension funds
>
> (3) Where a charge is made or transferred to the trustee or trustees of a registered pension fund or plan within the meaning of subsection 248(1) of the Income Tax Act (Canada), and the charge or transfer of charge has attached thereto a statement made by one of the trustees or a solicitor deposing that the fund or plan is so registered, the chargee or transferee may be described in the charge or transfer of charge as the trustee or trustees, naming the fund or plan, and the individual names of the trustee or trustees are not required.
>
> Idem
>
> (4) A transfer or cessation of a charge made by the trustee or trustees mentioned in subsection (3) shall not be registered unless there is attached thereto a statement made by the trustee or, where there is more than one trustee, by one of them or by the solicitor for the trustee or trustees, deposing that the signing trustee is, or trustees are, authorized to execute the transfer or cessation.

As ss. 62(2) states, the LTA permits an owner of real property, to which the Act applies, to be described on title as a trustee without offending ss. 62(1) of the LTA, and there is no requirement that there be greater than one owner to be able to record trustee capacity. Despite these clear legislative provisions, administrative policies in Ontario have taken hold that impede the long-standing use of trusts to hold real property to the point where misconceptions have developed that Ontario law no longer permits real property to be held in trust. This is not correct.

For a more detailed discussion of the issues related to the provisions of the LTA and the impact of current administrative policies in Ontario, we refer you to the article "Real Estate Meets Trust Law: Land Registration Ontario Style" written by Blair Botsford.[7]

An option that should exist to address the above-noted issues regarding holding real property in an alter ego or joint partner trust is to have sufficient multiple trustees named as the original trustees so that there will be ongoing successors (or continuing trustees) until the trust is terminated. This helps to avoid the need to have successor trustees appointed pursuant to provisions of the trust deed, and, generally, should also avoid any need for probate. In this regard, we refer you to section 9 of Ontario's *Trustee Act,*[8] which states:

> Vesting of trust property in new or continuing trustees without conveyance
>
> 9 (1) Where an instrument, executed after the 1st day of July, 1886, by which a new trustee is appointed to perform any trust, contains a declaration by the appointor to the effect that any estate or interest in any land subject to the trust, or in any personal estate so subject, shall vest in the person or persons who, by virtue of such instrument, shall become and be the trustee or trustees for performing the trust, that declaration shall, without any conveyance or assignment, operate to vest in the trustee, or in the trustees as joint tenants, and for the purposes of the trust, that estate, interest or right.
>
> On retirement of a trustee
>
> (2) Where such an instrument, by which a retiring trustee is discharged under this Act, contains such a declaration as is in this section mentioned by the retiring and continuing trustees, and by the other person, if any, empowered to appoint trustees, that declaration shall, without any conveyance or

assignment, operate to vest in the continuing trustees alone as joint tenants, and for the purposes of the trust, the estate, interest or right to which the declaration relates.

Application to mortgages, stocks, shares, etc.

(3) This section does not extend to land conveyed by way of mortgage for securing money subject to the trust, or to any share, stock, annuity, or property transferable only in books kept by a company or other body, or in a manner prescribed by or under an Act of the Parliament of Canada or of the Legislature.

Interpretation for registration purposes

(4) For the purpose of registration the persons making the declaration shall be deemed the conveying parties, and the conveyance shall be deemed to be made by them under a power conferred by this Act.

[*Emphasis added*.]

Where there is or may be a need to appoint successor trustees (i.e., if there are no continuing trustees), a solution is to have the trust deed contain appropriate provisions such that there is always a trustee appointor who derives his or her authority from the trust deed or a related deed of appointment, which can be a separate instrument or contained in a Will. If contained in a Will, the authority of the appointor or a successor trustee appointed in a Will is not dependent on probate of the Will (just as beneficiary designations contained in a Will are not dependent on probate); however, third parties may take a different view, which could lead to challenges and delay.

It is a rare case in which the appointment of a successor trustee should be dependent on probate. Aside from the provisions of the applicable trust deed itself, Ontario's *Trustee Act* contains various provisions to address the possibility of vacancies in the role of trustee, which are set out below. These provisions address what persons have authority to appoint a replacement trustee or temporarily act in place of trustees who can no longer act and, in some cases, the grant of that authority may be contained in a Will instrument but this does not cause the property to form part of an estate trustee's estate. Regardless of the source of the authority to appoint successor trustees, the persons beneficially entitled to the use and enjoyment of the real property are still governed by the trust deed. Changing legal title from one trustee to another is necessary to give effect to the successor trustee's fiduciary duty to take control of property for which they are responsible.

It should be noted that s. 139 of the LTA states that all provisions of the *Trustee Act* that are not inconsistent with the LTA apply to the LTA. Further, s. 124 of the LTA gives the Director of Land Titles authority to determine the evidence that is acceptable to determine entitlement to land. Where real property is held in a trust, it is not part of a person's estate and, therefore, it is outside the probate process.

Trustee Act Excerpts

Power of appointing new trustees

3 (1) Where a trustee dies or remains out of Ontario for more than twelve months, or desires to be discharged from all or any of the trusts or powers reposed in or conferred on the trustee, or refuses or is unfit to act therein, or is incapable of acting therein, or has been convicted of an indictable offence or

> is bankrupt or insolvent, the person nominated for the purpose of appointing new trustees by the instrument, if any, creating the trust, or if there is no such person, or no such person able and willing to act, the surviving or continuing trustees or trustee for the time being, or the personal representatives of the last surviving or continuing trustee, may by writing appoint another person or other persons (whether or not being the persons exercising the power) to be a trustee or trustees in the place of the trustee dying, remaining out of Ontario, desiring to be discharged, refusing or being unfit or incapable.
>
> [*Emphasis added*.]
>
> Survivorship
>
> (2) Until the appointment of new trustees, the personal representatives or representative for the time being of a sole trustee, or where there were two or more trustees, of the last surviving or continuing trustee, are or is capable of exercising or performing any power or trust that was given to or capable of being exercised by the sole or last surviving trustee.
>
> Authority of surviving trustee to appoint successor by will
>
> 4 Subject to the terms of any instrument creating a trust, the sole trustee or the last surviving or continuing trustee appointed for the administration of the trust may appoint by will another person or other persons to be a trustee or trustees in the place of the sole or surviving or continuing trustee after his or her death.
>
> Power of court to appoint new trustees
>
> 5 (1) The Superior Court of Justice may make an order for the appointment of a new trustee or new trustees, either in substitution for or in addition to any existing trustee or trustees, or although there is no existing trustee.

The authority of an executor or estate trustee is derived from the Will and not the grant of probate.[9] The case of *Chetty v. Chetty* states "It is quite clear that an executor derives his title and authority from the will of his testator and not from any grant of probate." Therefore, where there is a Will of the sole remaining trustee and no other person entitled in priority to name a successor trustee, the responsibility to appoint successor trustees falls to the estate trustee(s) named in the Will who are willing and able to so act as estate trustee(s). Only in the event of an intestacy would probate be needed to validly appoint an estate trustee (since there would be no one with the authority to act in such role) who is then able to appoint successor trustees.

The settlor of a trust can include provisions in the deed for naming successor trustees as well as granting authority to someone to appoint successor trustees. The exercise of this authority generally does not have to be through a Will instrument and other acceptable instruments such as a deed of appointment do not have a verification process. Why then should the use of a Will to exercise authority, or application of certain provisions of the *Trustee Act* necessitate a probate application in order to effect the appointment of a successor trustee?

It is noteworthy that there is a fundamental difference between the situation where real property is subject to an *inter vivos* trust and the trustee appointor is the estate trustee of the sole remaining trustee compared to real property forming part of a deceased's estate and becoming vested in the estate trustee pursuant to ss. 2(1) of the *Estates Administration Act,*[10] which provides:

> Devolution to personal representative of deceased
>
> 2 (1) All real and personal property that is vested in a person without a right in any other person to take by survivorship, on the person's death, whether testate or intestate and despite any testamentary disposition, devolves to and becomes vested in his or her personal representative from time to time as trustee for the persons by law beneficially entitled thereto, and, subject to the payment of the person's debts and so far as such property is not disposed of by deed, will, contract or other effectual disposition, it shall be administered, dealt with and distributed as if it were personal property not so disposed of.

In the former situation, the real property does not vest in the personal representative of the sole surviving trustee. All that occurs is that the personal representative has the right to name the successor trustee(s) and that right either flows from the last Will of the deceased trustee or the grant of probate with respect to the deceased trustee's estate. This is why, as stated above, the number of times where probate should be required in order for a successor trustee to be validly appointed should be small. In the event probate is required to facilitate the appointment of a successor trustee, this does not vest the real property that is subject to the trust in the personal representative of the deceased trustee who is only the trustee appointor.

Selecting a Trustee and Inclusion of Third Party and Reserved Powers

In light of the current administrative policy that exists in Ontario, it is easy to see why a client may want to take steps at the planning stage to avoid the need to probate a deceased trustee's Will in the future, making the decision of who should be named as trustee(s) of the trust that much more important. One option is naming children or other family as joint trustees with the settlor of an alter ego or joint partner trust, but this is not an attractive option to all clients (as we discuss further below). Institutional trustees could also be an option, but there are fees involved and not everyone is comfortable with this option. Fortunately, if the client is comfortable naming a family member or institutional trustee, involvement of family or an institutional trustee does not have to be an all or nothing solution. One option is to have a combination of family and institutional trustee, or have the institutional trustee as an alternate to certain family members, or in the event that no family is available.

Another option is the use of a private trust corporation (sometimes referred to as a "PTC") which can be custom-tailored to suit the particular circumstances including using professional service providers to fill certain key roles in the corporation. A discussion of PTCs is outside the scope of this article.

Part of the objections some clients have to involving family or institutional trustees is perceived loss of control and the desire to maintain privacy and independence. The counterpoint is that there is no one to assist or notice if there is cognitive decline or manipulation taking place. Fortunately, it is possible to structure trustee powers in such a manner that the settlor does not have to give up all control while alive and capable. This can be achieved by selecting from a broad range of third-party and reserved powers, which is a common strategy with international trust planning designed to craft bespoke solutions. As discussed below, care needs to be exercised when applying these planning strategies in jurisdictions such as Canada to trusts other than self-benefit trusts, as there can be adverse tax consequences. There can also be non-tax implications regardless of the residence or proper law of the trust.

Fortunately, alter ego and joint partner trusts are a form of self-benefit trust used for non-income tax planning purposes, which means the client potentially has more flexibility to use third-party and reserved powers (hereafter collectively referred to as "reserved powers"). Comments we often hear from clients contemplating self-benefit trusts is that they do not want to have joint trustees, such as their children, because they do not

want to give up control or seek cooperation from the co-trustees to: draw income; dispose of assets; make investment decisions; or select investment advisors. Reserved powers are a possible answer to these concerns.

As an example, Mrs. A can set up an alter ego trust for herself and transfer her home, cottage and non-registered investment accounts to the trust. She can appoint herself and her two sons as the three initial co-trustees with a majority rules clause. Mrs. A can also state that while she is alive and capable, she has the sole discretion to withdraw income and capital as she determines and to dispose of property. Further, Mrs. A can reserve the power to make investment decisions and select investment advisors. All other decisions would be made by the three trustees pursuant to the terms of the trust deed and applying the majority rules clause. Absent a common disaster, there should be at least one trustee left alive when Mrs. A dies to avoid a demand from third parties such as an Ontario land registration office: win-win.

Other third-party and reserved powers for consideration include:

- Trustee appointor;
- Advisory trustee;
- Custodian trustee;
- Protector;
- The ability to add or remove trustees and/or beneficiaries;
- The ability to relocate the trust to another jurisdiction;
- The power to terminate the trust;
- The power to determine the final distribution;
- The power to appoint or be an arbitrator in disputes;
- The power to veto distributions;
- The power to make amendments to the trust deed; and
- A requirement to consent to certain other fiduciary decisions (e.g., the sale of a heritage asset).

These powers can be sub-classified as either dispositive or administrative in nature.

The residency of the persons to whom these powers are allocated can potentially impact the tax residence of a trust under the central control and management test set out in Fundy Settlement.[11] However, the attribution rules in s. 75(2) of the ITA apply to self-benefit trusts during the lifetime of the settlor, which means this only becomes a concern after the death of the settlor if the trust is to continue for a period of time. One option if continued trust planning is needed after the death of the settlor, is to have the remainder of the initial trust held upon a new trust with appropriate structuring to take account of the changed circumstances.

Reserved powers may also be viewed by creditors to be property, and this depends on the nature and extent of the powers held by the power holder. Such an outcome could lead to those powers being used by a creditor or assignee to access the trust property, thereby defeating one of the common purposes of a trust.

The most well-known case in this area in the common law world is *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company (Cayman) Ltd and others (Cayman Islands),*[12] where the settlor's power to revoke the trust was held to amount to a property right which could be pursued by the settlor's creditors. Powers as property claims have most commonly been brought in a relationship property context but this could be grounds for future trust litigation. It is notable that, to date and with some notable exceptions, creditors have been less inclined to attack trusts on this basis in a commercial context.

If asset protection is a key goal of a trust, having the settlor reserve certain powers may be at odds with this goal given the above comments. In the context of self-benefit trusts such as alter ego trusts, the primary goals are usually not asset protection although it is possible, in which case additional care is needed in structuring the trust beyond considering the implications of reserved powers.

For those prioritizing asset protection, the case law is clear that ensuring the powers cannot be exercised for self-benefit is an important way to help manage the risk of challenge to a trust arising from the reservation of powers. Further:

1. Less is more; the less control (or potential control) a settlor has over the trust property, the more likely it is that they will have successfully established a trust. Settlor control can be limited by appointing someone other than the settlor to hold powers, and/or by preventing the settlor from being able to appoint trust assets to themselves.

2. Prescribed consent powers are less likely to cause issues than powers to give prescribed directions. In other words, when reserving powers to the settlor, requiring the settlor's consent for certain actions gives the settlor less control than requiring the trustees to follow the settlor's directions. Furthermore, limiting the class of decisions in respect of which the trustees must seek the protector's approval reduces the settlor's control further.

The authors argue that a settlor expressly reserving powers to themselves in the trust deed can be a more authentic arrangement than one where the trust is settled on discretionary terms, but where the trustees accede to the settlor's every request. However, the cases on this issue illustrate an inherent risk that where a settlor has reserved certain powers to themselves, the trust could be deemed by a court to not be validly constituted or the powers deemed to be the property of the settlor, as discussed above. As a result, trust deeds should clearly state the purpose and nature of the powers.

Another potential issue arises from the way current case law determines whether the powers are personal or fiduciary. This is generally done on a case-by-case basis having regard to the nature and purpose of the power. This can result in uncertainty for drafters of many trust deeds as to the parameters of the power holder's responsibilities and obligations. That uncertainty can be mitigated by clearly stating, through drafting the trust deed, the purpose of the power and whether it is inherently personal or fiduciary in its nature.

(For an additional discussion with respect to third party and reserved powers, we refer you to the article "The Potential Vulnerability of Reserved Powers Trusts" co-authored by Chris Duncan and Henry Brandts-Giesen.[13])

Interpretation and Construction – Choosing the Proper Law of the Trust

To this point, our article has assumed that the proper law of the trust under consideration was that of a Canadian province or territory such as Ontario. However, even though mind and management of a trust may reside in Canada for tax residency purposes, it is possible for the proper law of the trust for the purposes of interpretation and construction to be that of a jurisdiction outside Canada. Popular choices include Jersey, Guernsey, Bermuda, BVI and Cayman.

There are several non-tax reasons for selecting one of these jurisdictions such as: enhanced privacy and asset protection; access to a broader range of fiduciary and investment services; access to specialized judiciary;

different trustee powers; accommodation of beneficiary residency; no accumulations period; and a longer perpetuity period. The ability to select a trust law jurisdiction outside the client's domestic country is embedded in the Hague Convention of July 1985 on the Law Applicable to Trusts and on their Recognition, relevant provisions of which are as follows:

> Article 2
>
> For the purposes of this Convention, the term "trust" refers to the legal relationships created - inter vivos or on death - by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.
>
> A trust has the following characteristics -
>
> a) the assets constitute a separate fund and are not a part of the trustee's own estate;
>
> b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
>
> c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.
>
> The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.
>
> Article 3
>
> The Convention applies only to trusts created voluntarily and evidenced in writing.
>
> Article 6
>
> A trust shall be governed by the law chosen by the settlor. The choice must be express or be implied in the terms of the instrument creating or the writing evidencing the trust, interpreted, if necessary, in the light of the circumstances of the case.
>
> Where the law chosen under the previous paragraph does not provide for trusts or the category of trust involved, the choice shall not be effective and the law specified in Article 7 shall apply.
>
> Article 7
>
> Where no applicable law has been chosen, a trust shall be governed by the law with which it is most closely connected.
>
> In ascertaining the law with which a trust is most closely connected reference shall be made in particular to -
>
> a) the place of administration of the trust designated by the settlor;

b) the situs of the assets of the trust;

c) the place of residence or business of the trustee;

d) the objects of the trust and the places where they are to be fulfilled.

Article 8

The law specified by Article 6 or 7 shall govern the validity of the trust, its construction, its effects, and the administration of the trust.

In particular that law shall govern -

a) the appointment, resignation and removal of trustees, the capacity to act as a trustee, and the devolution of the office of trustee;

b) the rights and duties of trustees among themselves;

c) the right of trustees to delegate in whole or in part the discharge of their duties or the exercise of their powers;

d) the power of trustees to administer or to dispose of trust assets, to create security interests in the trust assets, or to acquire new assets;

e) the powers of investment of trustees;

f) restrictions upon the duration of the trust, and upon the power to accumulate the income of the trust;

g) the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries;

h) the variation or termination of the trust;

i) the distribution of the trust assets;

j) the duty of trustees to account for their administration.

[*Emphasis added*.]

Article 9

In applying this Chapter a severable aspect of the trust, particularly matters of administration, may be governed by a different law.

Article 10

The law applicable to the validity of the trust shall determine whether that law or the law governing a severable aspect of the trust may be replaced by another law.

Article 11

A trust created in accordance with the law specified by the preceding Chapter shall be recognised as a trust.

Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.

In so far as the law applicable to the trust requires or provides, such recognition shall imply, in particular

a) that personal creditors of the trustee shall have no recourse against the trust assets;

b) that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;

c) that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;

d) that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.

Article 15

The Convention does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating in particular to the following matters -

a) the protection of minors and incapable parties;

b) the personal and proprietary effects of marriage;

c) succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives;

d) the transfer of title to property and security interests in property;

e) the protection of creditors in matters of insolvency;

f) the protection, in other respects, of third parties acting in good faith.

> If recognition of a trust is prevented by application of the preceding paragraph, the court shall try to give effect to the objects of the trust by other means.
>
> Article 16
>
> The Convention does not prevent the application of those provisions of the law of the forum which must be applied even to international situations, irrespective of rules of conflict of laws.
>
> If another State has a sufficiently close connection with a case then, in exceptional circumstances, effect may also be given to rules of that State which have the same character as mentioned in the preceding paragraph.
>
> Any Contracting State may, by way of reservation, declare that it will not apply the second paragraph of this Article.

The full text of the July 1985 Hague Convention with respect to choice of trust law can be viewed at https://www.hcch.net/en/instruments/conventions/full-text/?cid=59.

Canada is a signatory to this Convention and has not opted out of its application. Ontario's *Trustee Act* contains provisions that are relevant to the Convention, being:

> Application of Act
>
> 66 Subject to section 67, unless otherwise expressed therein, this Act applies to all trusts whenever created and to all trustees whenever appointed.
>
> Powers, etc. under Act and trust instrument
>
> 67 The powers, rights and immunities conferred by this Act are in addition to those conferred by the instrument creating the trust, and have effect subject to the terms thereof.
>
> Express terms of trust instrument to prevail
>
> 68 Nothing in this Act authorizes a trustee to do anything that the trustee is in express terms forbidden to do, or to omit to do anything that the trustee is in express terms directed to do by the instrument creating the trust.
>
> [*Emphasis added*.]

While there can be circumstances where using a non-resident trust may be appropriate for Canadian clients, it not always necessary or desirable. Instead, international trust law concepts and tools can be used to enhance the functionality of trusts resident in Canada, and address some unique challenges related to real property. How to strike the right balance depends on the needs and priorities of individual clients.

[1] Partner, O'Sullivan Estate Lawyers LLP.
[2] Partner, Dentons Kensington Swan.
[3] For a more detailed discussion of the presumption of resulting trust and related issues, see "Gratuitous Transfers and Presumptions: The Journey From Pecore to Mak (Estate) and Beyond", Blair L. Botsford and Matthew Rendely, Federated Press, Volume X, No. 3.
[4] *Income Tax Act*, R.S.C. 1985, c 1 (5th Supp), s. 248(1) ("**ITA**").
[5] It should be noted that the 21-year rule does not apply with respect to trusts where all of the interests are fixed. See clause 108(1)(g) of the ITA with respect to the definition of "trust".
[6] *Land Transfer Tax Act*, R.S.O. 1990, c. L.6.
[7] *Real Estate Meets Trust Law: Land Registration Ontario Style*, Blair L. Botsford, Ontario Bar Association, March 03, 2020.
[8] *Trustee Act*, R.S.O. 1990, c. T.23.
[9] *Chetty v. Chetty*, [1916] 1 A.C. 603 (Singapore P.C.).
[10] *Estates Administration Act*, R.S.O. 1990, c. E.22.
[11] *Garron Family Trust (Trustee of) v. R.*, 2012 SCC 14 , (*sub nom.* Fundy Settlement v. Canada) [2012] 1 S.C.R. 520 (S.C.C.).
[12] *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company (Cayman) Ltd and others (Cayman Islands)*, [2011] UKPC 17.
[13] "The Potential Vulnerability of Reserved Powers Trusts", *Trusts & Trustees*, Vol, 27, No. 3, April 2021, pp.194-200, Chris Duncan and Henry Brandts-Geisen.

GIFTS OF ECOLOGICALLY SENSITIVE LAND FOR TAX PLANNING PURPOSES

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Gifts of private land are becoming increasingly important to the preservation of Canada's environmental heritage. The federal Ecological Gifts Program (the "**EGP**") provides a way for Canadians who hold ecologically sensitive land to simultaneously protect nature for future generations and attract favourable tax consequences. This article briefly addresses the benefits, requirements, and risks of donating ecologically sensitive land from a tax planning perspective. Other requirements relating to this potential transaction — such as the real property legal requirements — are outside the scope of this brief article.

Benefits of Donation

Two sections of the *Income Tax Act*[1] (the "**ITA**") govern gifts of ecologically sensitive property. Subsection 118.1(1) of the ITA governs gifts for individuals, while subsection 110.1(1) governs gifts for corporations. In Quebec, the process is also governed by the *Quebec Taxation Act.*[2] If the requirements are met, corporate donors may deduct the amount of their ecological gift directly from their taxable income. An individual donor receives a non-refundable tax credit. In addition, the tax payable on a capital gain arising on a qualifying ecological gift is reduced to nil. There is currently a 10-year carry-forward period for claiming these benefits.

Process for Donation

Gifts of ecologically sensitive property can be a useful tax reduction tool when made by *inter vivos* or testamentary disposition, but each method has its own considerations to keep in mind.

Inter Vivos Gifts

When making an ecological gift *inter vivos*, the donor may lose their personal use of the land following donation. Another consideration for an *inter vivos* donation is the importance of a well-drafted gift agreement.

Testamentary Gifts

A potential donor must keep in mind the intricacies in choosing to give a gift of ecological property by means of a testamentary gift made through their estate.

A testamentary gift can provide the donor with lifelong use of the property, but can create complexities in the donor's estate. For clarity, such testamentary gifts are only for individuals. When making an ecological gift by will, the donor's estate plan should contemplate the steps that will need to be taken by their executor(s) in connection with the gift. If the gift is made as a consequence of the death of the donor then it will qualify for the nil capital gains inclusion only if the gift is made by a graduated rate estate.

An estate may be designated as a graduated rate estate following a testator's death if certain criteria in the ITA are met. The first includes the trust being designated as a "testamentary trust" according to the ITA.[3] The additional criteria include: designation of that testamentary trust as a graduated rate estate in its first T3 tax return (i.e., the first taxation year filing) following the testator's date of death; inclusion of the testator's social insurance number on the estate's tax return; and the fact that no other estate of the testator claims the

graduated rate estate status.[4] Status as a graduated rate estate remains in place for 36 months following the testator's date of death if these criteria remain in place. Relevant to this article, it is critical that tax planning which relies on the estate's status as a graduated rate estate — such as the gift of ecologically sensitive land to an eligible recipient (outlined below) which is either a public foundation or charitable organization, as defined in the ITA — occur within the time period requirements for graduated rate estates.

Subsection 118.1(5.1) of the ITA provides for some additional flexibility regarding the timing of when a gift can be transferred to the eligible recipient. Specifically, this subsection provides that the gift can be made following the end of the 36-month deadline of the graduated rate estate status so long as it is made before the end of 60 months following the testator's date of death if the estate would otherwise meet the criteria of a graduated rate estate (but for the expiration of time). The implication of an estate not meeting the aforementioned critical deadlines is that the testator's estate (and its beneficiaries) may not be able to benefit from the favourable tax treatment that often motivates a testator to plan for such a process to be undertaken.

It is an unfortunate reality for most estates that, despite the additional flexibility provided by subsection 118.1(5.1), the complexities of the process detailed in this article may make it difficult for executors to meet the critical timelines for transferring the ecologically sensitive property to the eligible recipient. As such, it is important that testators and their executor(s) are well advised of these possible issues, and that executors commence the process detailed in this article as soon as possible following the testator's death.

Criteria for Gifts of Ecological Property

In order for donors to receive the tax benefits from both *inter vivos* and testamentary gifts of ecological property in provinces other than Quebec, three main requirements must be met. The land must (i) be donated to an eligible recipient, (ii) be certified as "ecologically sensitive land" by the federal Minister of Environment and Climate Change (the "**Minister**") and (iii) obtain a certified fair market value from the Minister. A discussion of these three requirements follows.

Uniquely in Quebec, the ecological gift process is the joint responsibility of the federal government and the provincial government. The Ministère de l'Environnement, de la Lutte contre les changements climatiques, de la Faune et des Parcs[5] (**"MELCCFP**") is responsible for certifying the eligible recipient and the land's ecological value (being criteria 1 and 2 below), while Environment and Climate Change Canada[6] (the "**Ministry**") certifies the fair market value of the land (being criteria 3 below).

1. Donation to Eligible Recipient

The ecologically sensitive land must be given to the federal government or a provincial government in Canada, a municipality, a municipal or public body performing a function of government in Canada, or a Canadian registered charity. In the case of a registered charity, the charity must be designated as either a public foundation or charitable organization that has a charitable purpose that aligns with conservation of the environment. Importantly, private foundations cannot be eligible recipients.

2. Certification of "Ecologically Sensitive Land"

Pursuant to subsection 118.1(1)(a)(ii) of the ITA, land that is the subject of an ecological gift must be:

> *…certified by that Minister, or by a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of the Minister or the designated person, important to the preservation of Canada's environmental heritage.*

The donor must apply to the Minister or a delegated authority for this certification. The donor, often in partnership with the recipient, collects required information and submits it to its regional EGP coordinator or a delegated certification authority. Contact information for regional EGP coordinators is available on the Government of Canada website.[7]

A formal application form is not currently available, but the Ministry provides a list of information which the donor must provide. For example, the donor must provide certain personal information as well as information on each potential recipient of the land. If a potential recipient is a charity, the donor should be prepared to demonstrate that the registered charity is eligible. The donor must also provide information on the subject land itself, such as a legal description of the property and a brief assessment of its ecological character. This assessment could include, among other things, a description of different habitat types on the property (e.g., wetland, forest, or grassland) or a description of any significant species known to be present.

Any potential donors should review the list of required information on the Ministry's website[8] in detail. Certain provinces have additional unique requirements, so it is important to review the criteria for the relevant jurisdiction by contacting its regional EGP coordinator, or MELCCFP in the case of Quebec.

Potential tax benefits are available for gifts of land or eligible interests in land, depending on the province. In the case of land in Quebec, eligible interests in land include a personal servitude or a real servitude. Outside of Quebec, eligible interests include covenants and conservation easements. Put simply, how title to the real property composing the potential gift is held is not the most relevant nor important to the Minister's assessment of the application. Instead, in order to qualify, all ecologically sensitive lands must be found to be significant to the conservation of Canada's biodiversity and environmental heritage. In making this assessment, the Ministry considers not only the current environment value but also the potential future environmental value of the land. Currently, the Minister makes this determination based on the following criteria:

a) areas identified, designated or protected by a local, provincial, territorial, national or international system or body as ecologically significant or ecologically important;
b) natural spaces of significance to the environment in which they are located;
c) sites that have significant current ecological value, or potential for enhanced ecological value, as a result of their proximity to other significant properties;
d) municipal or rural lands that are zoned or designated for biodiversity objectives;
e) natural buffers around environmentally sensitive areas such as water bodies, streams or wetlands; and
f) areas or sites that contribute to the maintenance of biodiversity or Canada's environmental heritage.

However, there is a possibility that additional factors may be relevant to the Minister's determination, including applicable provincial criteria. For example, in Ontario, land falling into the category of "Provincially Significant Wetlands" is deemed to be ecologically sensitive land.[9] Overall, in submitting their assessment of the land's ecological character, the donor's goal should be to demonstrate that any applicable national or provincial criteria have been met.

3. Certification of Fair Market Value

If the applicant is successful with the certification of ecological sensitivity, then they must also obtain the fair market value determination from the Minister regarding the prescribed value of the real property that the applicant wants to donate to the eligible recipient. This determination is material to the value of the donor's tax credit, which in many cases is a critical factor to the donor's ultimate decision to donate the land.

The administrative procedures to be followed in respect of a request for a determination or redetermination of fair market value by the Minister are set out in subsections 118.1(10.2) to (10.5) of the ITA. The donor or recipient must commission an independent appraisal of the fair market value of the donated lands and submit it to the regional EGP coordinator, along with a signed Application for Appraisal Review and Determination.[10] The appraisal is reviewed by the Ministry's Appraisal Review Panel, after which the donor will receive a notice of determination indicating the fair market value that the Minister is prepared to certify. This can be a contentious finding, as donors naturally hope to receive the highest fair market value certification possible in order to maximize their potential tax benefits. As such, within 90 days of receiving the notice of determination, the donor may either accept the fair market value as certified by the Minister, request a redetermination under subsection 118.1(10.4) of the ITA if dissatisfied with the Minister's findings, or withdraw from the program by notifying Environment and Climate Change Canada.

Once the land is transferred to and received by the eligible recipient and proof of the registered transfer of the land is provided to the Minister, then a "Statement of Fair Market Value" is issued to the donor from the Minister. In Quebec, such a "Statement of Fair Market Value" is also to be signed by MELCCFP so that the donor is eligible for provincial tax benefits. If donors are still dissatisfied with the fair market value of the donated property as certified by the Minister, an appeal may be made to the Tax Court of Canada and, in the case of land in Quebec, to the Court of Quebec.

Tax Treatment

It is important to note that Environment and Climate Change Canada does not determine what constitutes a gift under the ITA and at law. As such, potential donors should consider contacting their tax and legal advisors before applying to the EGP due to the intricacies associated with such a gift. Furthermore, potential donors should be aware that it is possible that following the conclusion of the Ministry's process (outlined in this article), the Canada Revenue Agency ("**CRA**") may choose to reassess the donor's gift of land and treat it as a disposition of inventory generating income for a business, as opposed to the realization of a capital gain. This is a possibility particularly where individual or corporate donors engage in some level of business related to land holding or development.

In such circumstances, the elimination of any taxable capital gain and the inclusion of the capital gain in the capital dividend are benefits that do not apply. Instead, the proceeds of disposition are treated as taxable income, which can be offset by corresponding deduction or tax credit. This was the case in *Staltari v. R.*,[11] in which a gift of ecologically sensitive land was reassessed by CRA and treated as a disposition of inventory because the taxpayer was a real estate specialist who often sold properties for others. In this case, the Tax Court of Canada ultimately found no evidence that the taxpayer acquired the land in connection with a business and did not attribute a profit motive to the taxpayer. Even so, the case serves as a reminder that a donor could be surprised down the road by reassessments which could cost them additional time and money to address.

Conclusion

In order to receive the tax benefits stemming from a qualifying gift of ecologically sensitive property, a donor is required to arrange a donation to an eligible recipient and receive certifications regarding the ecological sensitivity and fair market value of the land. These steps can be onerous to complete, and the timeline for the entire process can be uncertain given that it is largely dependant on ministerial discretion. However, if the application and appraisal contain all the required information, the Notice of Determination of Fair Market Value is typically issued within 90 days of receipt. Timelines are similar for the issuance of certificates of ecological sensitivity. Despite the risks and the specific requirements, gifts of ecologically sensitive property can be rewarding for donors and ensure the preservation of Canada's environmental heritage.

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[1] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp).
[2] *Taxation Act*, C.Q.L.R., c I-3, Part 4.
[3] ITA, *supra* note 1 at ss. 108(1).
[4] See Elena Hoffstein, "Testamentary charitable giving and the graduated rate estate: A refresher" (16 May 2023), online: https://www.mondaq.com/canada/capital-gains-tax/1315578/testamentary-charitable-giving-and-the-graduated-rate-estate-a-refresher.
[5] Ministère de l'Environnement, de la Lutte contre les changements climatiques, de la Faune et des Parcs, online: https://www.environnement.gouv.qc.ca/.
[6] Environment and Climate Change Canada, online: https://www.canada.ca/en/environment-climate-change.html.
[7] Environment and Climate Change Canada, *Ecological gifts: contacts* (Ottawa: 2022), online: https://www.canada.ca/en/environment-climate-change/services/environmental-funding/ecological-gifts-program/contacts.html.
[8] Environment and Climate Change Canada, *Ecological gifts: assessing ecological sensitivity* (Ottawa: 2022), online: https://www.canada.ca/en/environment-climate-change/services/environmental-funding/ecological-gifts-program/assessing-sensitivity.html.
[9] *Ibid*.
[10] Environment and Climate Change Canada, *Ecological gifts: application for appraisal and fair market value* (Ottawa: 2022), online: https://www.canada.ca/en/environment-climate-change/services/environmental-funding/ecological-gifts-program/publications/application-appraisal-fair-market-value.html#toc2.
[11] 2015 TCC 123 (T.C.C. [General Procedure]).

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