



**OLD TRAPS, NEW TEETH:  
THE NEW BITE OF EXISTING TAX TRAPS  
FOLLOWING THE INTRODUCTION OF  
THE ENHANCED TRUST REPORTING RULES**

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# Old Traps, New Teeth: The New Bite of Existing Tax Traps Following the Introduction of the Enhanced Trust Reporting Rules

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## 1. Introduction

The enhanced trust reporting rules, effective for taxation years ending after December 30, 2023, represent a significant expansion of the annual filing and disclosure obligations for trusts. The enhanced rules significantly increase the number of trusts that must file T3 returns, increase the frequency with which returns must be filed and increase the volume of information that is collected with each filing.

A key component of these new requirements is the introduction of Schedule 15, “Beneficial Ownership Information of a Trust.” Deemed trusts<sup>1</sup> that are not excluded pursuant to proposed subsection 150(1.31) of the *Income Tax Act* (the “*ITA*”) and other express trusts that are not excluded pursuant to subsection 150(1.2) of the *ITA* must file a completed Schedule 15 together with their T3 returns. This schedule mandates that affected trustees disclose detailed information about all “reportable entities” of the trust, which includes all trustees, beneficiaries (including contingent and unknown beneficiaries, to the extent their identity is known or ascertainable with reasonable effort), settlors (broadly defined as anyone who has transferred or loaned property to the trust, with certain exceptions for arm’s length transfers at fair market value or loans at reasonable rates of interest) and anyone with the ability to exert control over trustee decisions. If a beneficiary’s identity is not known or ascertainable with reasonable effort (e.g., unborn children), the trust must provide sufficient information to determine with certainty whether a particular person is a beneficiary.<sup>2</sup> For each of these entities, Schedule 15 requires that names, addresses, dates of birth (for individuals), country of residence (for tax purposes) and tax identification numbers (e.g., Social Insurance Number, Business Number or a foreign identification number) be provided.

The first year of implementation was met with significant confusion, largely because of a lack of clear guidance on what constitutes a “bare trust.” In response to public pressure, the Canada Revenue Agency (“CRA”) announced on March 28, 2024, that bare trusts would not be required to file a T3 return for the 2023 taxation year unless specifically requested by the CRA. This announcement came after over 43,000 returns had already been filed.

On August 12, 2024, further changes were announced to the trust reporting rules, with effect for the 2024 and subsequent taxation years. On August 15, 2025, the Minister of Finance (“Finance”)<sup>3</sup> released further draft legislation with additional changes to the trust reporting rules which are generally effective for fiscal periods starting after December 30, 2025 (with certain

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<sup>1</sup> See proposed subsection 150(1.3) to the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (“*ITA*”). All statutory references are to the *ITA* unless otherwise indicated.

<sup>2</sup> *Income Tax Regulations*, C.R.C., c. 945, s. 204.2.

<sup>3</sup> Francois-Philippe Champagne currently acts as both the Minister of Finance and as the Minister of National Revenue. Nonetheless, we refer to these roles separately in this paper.

exceptions). Finance is accepting comments on the draft legislative proposals until September 12, 2025.

A detailed discussion about the enhanced trust reporting requirements and the reporting obligations of bare trusts and other express trusts is beyond the scope of this paper and is very capably covered elsewhere.<sup>4</sup>

The enhanced trust reporting rules have been widely criticized for the increased compliance burden that they impose on taxpayers. However, a more significant concern is the vast amount of additional information now being collected and how the Minister of National Revenue (the "Minister") might use it.

This paper sets out a number of traps related to the taxation of trusts in Canada. These traps are, for the most part, not new. The Minister is aware of them and has been assessing taxpayers in respect of them for years. They are, nonetheless, worth reviewing at this stage as the CRA continues to gather vast quantities of information from taxpayers through the enhanced trust reporting rules. This paper seeks to underscore a few key areas in which increased risk is anticipated. Furthermore, it endeavors to highlight the traps into which taxpayers may fall when making various changes to the constitution of trusts (sometimes as a direct result of the enhanced trust reporting rules).

As the impact of some of the traps will depend on the fair market value of an interest in a discretionary trust, this paper will begin by discussing how interests in discretionary trusts may be valued by the Minister and by the tax and trust community. It will then examine select areas where the enhanced trust reporting rules may cause greater audit activity, including:

### *1. Beneficiary Issues*

It is often necessary (or desirable) to add or remove beneficiaries to a discretionary trust. Such a change may be made at the behest of the trustees or of the beneficiaries and may be made for any number of tax or non-tax reasons. In some cases, privacy concerns raised in respect of the introduction of the enhanced trust reporting requirements may, in and of themselves, spur the making of such requests. In our discussion of beneficiary issues, we will consider:

- (a) The removal of beneficiaries from an existing discretionary trust, including a discussion of the tax consequences of releases, disclaimers and surrenders;

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<sup>4</sup> See David Christian and Daniel Frajman, "Trust Reporting Under Federal and Quebec Legislation: A Comparison of Approaches to Transparency" in *Report of Proceedings of the Seventy-Sixth Tax Conference, 2024 Conference Report* (Toronto: Canadian Tax Foundation, 2025) 7: 1-45 and Joel Nitikman, "Grin and Bare It—The Recent Kerfuffle over Bare Trusts" in *Personal Tax Planning feature* (2024) 72:3 *Canadian Tax Journal* 671-94. In reviewing these papers, however, be mindful of the fact that both predate the August 15, 2025 draft legislative proposals and, therefore, will be somewhat out of date.

- (b) The addition of beneficiaries to an existing discretionary trust including a discussion of whether such additions result in dispositions by existing beneficiaries of their capital interests in the existing trust, the possibility that such a disposition may expose new beneficiaries to tax liabilities of existing beneficiaries and the possibility that a loss restriction event may be triggered.

### *Trustee Issues*

It may become necessary to appoint new trustees or to replace existing trustees several times during the life of a discretionary trust. We will examine the risk that a change in trustees will trigger an acquisition of control of corporations in respect of which the trust holds a majority of the voting shares as well as the potential tax implications.

### *General Issues*

We consider how various entities may become affiliated, associated, related or deemed to be acting at non-arm's length with one another through their participation in, or interaction with, trusts as well as the implications of such aggregations from a tax perspective.

Finally, we provide an update on the meaning of the term "payable" for the purposes of subsections 104(6) and 104(24) of the *ITA* in light of recent jurisprudence (including *Maurice Kissel Family Trust v. The King*<sup>5</sup> and *Evans et al. v. The Attorney General of Canada*<sup>6</sup>).

For the purposes of this paper, we assume that all relevant parties (including trustees, beneficiaries, settlors and corporations) are resident in Canada for tax purposes (unless otherwise indicated). Unless otherwise stated, comments in this paper relate to express trusts.

## **2. Valuation of an Interest in a Trust**

In discussing the features of a common law trust, *Waters' Law of Trusts in Canada* states the following:

The essential features of a common law trust . . . are a segregated fund comprising an asset or a number of assets, a person or purpose as the object of the trust with exclusive right to the enjoyment of the fund or its dedication, and a person holding title to the asset or assets held in the trust and in some instances administering or managing the fund.<sup>7</sup>

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<sup>5</sup> *Maurice Kissel Family Trust v. The King*, 2019-4092(IT)G (Unreported, oral reasons delivered on March 30, 2023) ("Kissel").

<sup>6</sup> *Evans et al. v. The Attorney General of Canada*, 2024 ONSC 1955 ("Evans").

<sup>7</sup> Donovan Waters, Mark Gillen, and Lionel Smith, *Waters' Law of Trusts in Canada*, 5th ed (Toronto: Carswell, 2021) at 3-4 ("*Waters' Law of Trusts in Canada*").

A trust, under Canadian law, is fundamentally a legal relationship rather than a separate legal entity. In the common law provinces, a trust arises when a settlor transfers property to a trustee, who then holds and manages that property for the benefit of one or more beneficiaries. The trust is not itself an entity; rather, it is a fiduciary relationship defined by the three certainties: certainty of intention to create a trust, certainty of subject matter (the trust property), and certainty of objects (the beneficiaries). In the case of an express trust, the trustee holds legal title to trust property subject to the terms of the trust for the benefit of the beneficiaries.

Subsection 104(2) of the *ITA* states that a trust shall, for the purposes of the *ITA* and in respect of trust property, be deemed to be an individual. Subsection 104(1) further notes that a reference to a trust or estate in the *ITA* shall be read to include a reference to the trustee, executor or other legal representative having ownership or control of the trust property (unless the context requires otherwise). As noted by Sharlow, J.A. in the Federal Court of Appeal decision of *Garron Family Trust (Trustee of) v. R.*, “[s]ection 104 was enacted to solve the practical problems of tax administration that would necessarily arise when it was determined that trusts were to be taxed despite the absence of legal personality.”<sup>8</sup> This is a legal fiction created for tax administration and does not alter the underlying legal nature of a trust as a relationship.

**(a) Non-Discretionary/Fixed Trusts**

A distinction is to be made between discretionary trusts and non-discretionary (or fixed) trusts.

A non-discretionary (or fixed) trust is a trust in which interests have vested or are contingent upon the happening of a certain event. Distributions are not at the discretion of a trustee or group of trustees; rather, the entitlements of beneficiaries are determined by the terms of the trust deed itself. A fixed trust was described in *Underhill and Hayton: Law of Trusts and Trustees* as follows:

Where a beneficiary has a current fixed entitlement to an ascertainable part of the net income or net capital, if any, of the trust fund after deduction of sums paid by the trustees in the exercise of their *administrative* powers of management, the beneficiary has a fixed interest which ranks as ‘an interest in possession’ under the trust.<sup>9</sup>

Valuing an interest in a non-discretionary trust is not a simple exercise (especially where the trustee continues to have discretion as to how to invest the underlying assets). However, there is little argument that such interests have value and that, with the assistance of a valuator, such value may be determinable.<sup>10</sup>

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<sup>8</sup> *Garron Family Trust (Trustee of) v. R.*, 2010 FCA 309 at para 64.

<sup>9</sup> David Hayton, Paul Matthews and Charles Mitchell, *Underhill and Hayton: Law of Trusts and Trustees*, 18th ed (London: LexisNexis, 2010) at 98 (“*Underhill and Hayton: Law of Trusts and Trustees*”). See also Roth, Ellie S., Chris Anderson, Kim Brown, Rhonda Rudick and Ryan Wolfe, *Canadian Taxation of Trusts*, 2nd ed. (Toronto: Canadian Tax Foundation, 2025) at 29 (“*Canadian Taxation of Trusts*”).

<sup>10</sup> It is of note that trusts do not necessarily fall neatly into the categories of discretionary and non-discretionary trusts. Trusts may be drafted so as to fix some interests while giving trustees discretion with respect to others. In some instances, these interests may intersect such that the exercise of a trustee’s discretion may affect the interests

The methodology appropriate for valuing interests in non-discretionary trusts is explained as follows by Richard Wise in his 2016 article (the “Wise Article”):

In basic terms, the value of a capital beneficiary's interest in a trust is calculated as the lump sum—the present value of the future stream of capital payments inuring to the capital beneficiary. Stated differently, the value is the lump sum amount that the beneficiary would accept as of the valuation date rather than await the future receipt of funds from the trust. Discounts, as appropriate, are then applied in respect of contingencies...<sup>11</sup>

In determining the present value of the future stream of capital payments, the factors typically considered by valuers would include the life expectancy of the beneficiary or beneficiaries, the composition of the trust assets, contingencies, income tax obligations, the encroachment rights of other beneficiaries, the expected rate of return on investments and the estimated timing and amounts of distributions.<sup>12</sup>

Far more controversial is the valuation of an interest in a discretionary family trust. We consider this further below.

**(b) Discretionary Trusts**

Professor Waters defined the term “discretionary trust” in *Waters’ Law of Trusts in Canada* as follows:

A discretionary trust arises when property is vested in trustees and a class of beneficiaries or named persons appear as the trust objects, but the trustees have complete discretion as to the payment of the income, or the capital, or both. The trust may obligate them to distribute all the trust property among the class, but give them a discretion as to whom they make payments within the class, and as to how much they pay to each.<sup>13</sup>

In other words, a trustee of a discretionary trust may be obligated to distribute trust property among a class of named beneficiaries; however, the trustee has discretion over when and how to make any such distributions. Trustees of discretionary trusts typically have the right, at their discretion, to make distributions to some beneficiaries to the exclusion of others. Where the trustees have the obligation to exercise their power, the power held by the trustees may constitute

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of fixed beneficiaries. Discretionary powers may also have some fixed elements to them. For example, a trustee may be required to make distributions on a given date, but may have discretion as to whom to make the distributions.

<sup>11</sup> Richard Wise, “Current Challenges by the CRA Involving Fair Market Value”, in *Report of Proceedings of the Sixty-Eighth Tax Conference*, 2016 Conference Report (Toronto: Canadian Tax Foundation, 2017) at 30:14 (*the “Wise Article”*).

<sup>12</sup> *Ibid* at 30:13.

<sup>13</sup> *Waters’ Law of Trusts in Canada*, supra note 7 at 691.

a “trust power”. Where, on the other hand, the trustees are under no obligation to exercise their power, such power may be referred to as “mere power”.<sup>14</sup>

There are two primary types of discretionary trusts. The first type is an "exhaustive" discretionary trust. Under this type of trust "the trustee must distribute the whole of the income or capital, or both, but retains the power to choose who among the potential beneficiaries should receive distributions, and in what amount".<sup>15</sup> The second type is a "non-exhaustive" discretionary trust, under which the trustee may "choose whether or not to make any distribution at all".<sup>16</sup>

It is of note that the term “discretionary trust” is not a term of art but, rather, according to some commentators, has no precise meaning.<sup>17</sup> This is especially so as terms of trusts vary widely and are often drafted creatively by practitioners with multiple objectives in mind.

(c) **What is the Nature of an Interest in a Discretionary Trust?**

In *S.A. v. Metro Vancouver Housing Corp.*,<sup>18</sup> the Supreme Court of Canada considered the question of whether the beneficial interest of the Appellant in a discretionary trust, specifically a Henson trust, constituted an “asset” for the purpose of determining the Appellant’s eligibility to participate in a rental subsidy program offered by Metro Vancouver Housing Corporation. While the Appellant was a co-trustee of the trust in question, she had no right to force distributions to be made and no ownership interest in the property held by the trust. Her rights as a beneficiary were limited to those that she held *vis-à-vis* the trust and its trustees. In discussing the respective rights and obligations of the Appellant and the trustees, Cote, J. noted that:

The foregoing analysis makes two things clear. First, the terms of the Trust provide the Trustees with exclusive discretion as to whether payments should be made to S.A. While the Trustees must periodically consider whether distributions should be made, they are not obliged to exercise this discretion in any particular manner. Second, the structure of the Trust prevents S.A. from terminating the Trust on her own under the rule in *Saunders v. Vautier*. As a result, S.A. has no enforceable right to receive any of the Trust’s income or capital: unless and until the Trustees exercise their discretion in her favour, S.A.’s interest in the Trust is akin to a mere hope that some or all of its property will be distributed to her at some point in the future. (Emphasis added).<sup>19</sup>

The Court went on to note that the mere fact that the Appellant holds an interest in the trust did “not mean that her financial situation is ameliorated in any meaningful way before distributions

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<sup>14</sup> *Canadian Taxation of Trusts*, *supra* note 9 at 30.

<sup>15</sup> *Ibid* at para 67.

<sup>16</sup> *Ibid*.

<sup>17</sup> Lynton Tucker, Nicholas Le Poidevin and James Brightell, *Lewin on Trusts*, 19th ed. (London: Sweet & Maxwell, 2015) at 29-024.

<sup>18</sup> *S.A. v. Metro Vancouver Housing Corp.*, 2019 SCC 4 (“*Metro Vancouver*”).

<sup>19</sup> *Ibid* at para 39.

are actually, if ever, made for her benefit.”<sup>20</sup> The Court therefore concluded that the Appellant holds no actual entitlement to the trust property, noting that her interest in the trust amounts to “a ‘mere hope’ that the trustees will exercise their discretion in a manner favourable to her...”<sup>21</sup> The Appellant’s interest in the trust was not an “asset” that could affect her eligibility to participate in a rental subsidy program.<sup>22</sup>

The comments made by Cote, J. are consistent with comments made by the Court in *Tremblay v. Tremblay*:

Traditional trust law principles are clear that a person who is the object of trustee discretion to pay out capital in his favour does not have an existing property interest. From a pure property law viewpoint, he has only what is termed an “expectancy”. He has the right to be considered by the trustees as a recipient under the trust in accordance with its terms and for the trustees to consider this issue acting in good faith in accordance with their fiduciary duty.<sup>23</sup> (Emphasis added).

*Metro Vancouver* and *Tremblay* are also consistent with key trust cases such as *Gartside v. I.R.C.*, where Lord Wilberforce noted that:

No doubt in a certain sense a beneficiary under a discretionary trust has an “interest”... he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. ... But that does not mean that he has an interest which is capable of being taxed by reference to its extent in the trust fund’s income: ...it may still lack the necessary equality of definable extent which must exist before it can be taxed.<sup>24</sup>

The CRA has taken a similar position. Notably, in a 2008 memorandum, the CRA noted that:

A beneficiary's beneficial interest in a trust that is wholly discretionary is essentially a right of that beneficiary to be considered by the trustee as to whether or not any trust property (income or capital or a mixture thereof) should, in the trustee's discretion, be distributed or paid to or otherwise transferred or used for the benefit of that beneficiary. That right to be so considered or the right to have that right protected by a Court is enforceable as such, although the right does not necessarily give to the beneficiary any entitlement to any proprietary or ownership interest or right to or in the discretionary

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<sup>20</sup> *Ibid* at para 49.

<sup>21</sup> *Ibid* at para 4.

<sup>22</sup> The Court did note, however, that the question of whether benefits from a discretionary trust would be treated as an asset could vary depending on the requirements of the program in question. See *Metro Vancouver* at para 55.

<sup>23</sup> *Tremblay v. Tremblay*, 2016 ONSC 588 at para 27 (“*Tremblay*”).

<sup>24</sup> *Gartside v I.R.C.*, [1968] 1 All E.R. 121 (U.K.H.L.) at 134 (“*Gartside*”). We also note that “the potential beneficiary of a discretionary trust has no actual proprietary interest in the fund unless a selection in their favour has been made”: Warren Barr and John Picton, *Pearce & Stevens’ Trusts and Equitable Obligations*, 7th ed. (Oxford: Oxford University Press, 2018) at 464.

trust's property: see *Gartside v. I.R.C.*, (1968) A.C. 553 (HL) ; *Vestey v. I.R.C.*, (1979) 54 T.C. 503 (HL).<sup>25</sup> (Emphasis added).

There is strong support for the proposition that an interest in a discretionary trust falls far short of creating any sort of right to the property held by the trustee for the benefit of the beneficiaries of the trust in question; rather, the interest is akin to a “mere hope” that a distribution will be made in the beneficiary’s favour or, alternatively, a right on the part of the beneficiary to be considered as a potential recipient of benefit from the discretionary trust. The question, then, is what value may be assigned to such a hope or right.

***(d) What is the Fair Market Value of an Interest in a Discretionary Trust?***

The *ITA* typically calculates proceeds in respect of the disposition of assets on the basis of the fair market value of the asset disposed of. The term “fair market value” is not defined in the *ITA*, but is used in excess of 1,000 times.<sup>26</sup> Fair market value is a question of fact<sup>27</sup> as is the value of an interest a discretionary family trust.<sup>28</sup>

The term “fair market value” was defined by Cattanach J. in *Henderson Estate and Bank of New York v. M.N.R.* as follows:

The statute does not define the expression “FMV,”...That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand. (Emphasis added).<sup>29</sup>

The Tax Court of Canada in *Carr v. The Queen*<sup>30</sup> noted that “[f]air market value is not defined in the *Act*. However, the judicial definition accepted by the courts in Canada is that of Cattanach J. in *Henderson Estate and Bank of New York v. M.N.R.*, 73 DTC 5471 (F.C.T.D.)...”

The CRA defines “fair market value” in Information Circular 89-3 as “the highest price, expressed in terms of money or money's worth, obtainable in an open and unrestricted market

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<sup>25</sup> CRA, Views, Interpretation – Internal, “2008-028141117 – Addition of Beneficiaries” (20 November 2008).

<sup>26</sup> The term “fair market value” is also not defined in the *Interpretation Act*, R.S.C., 1985, c. I-21.

<sup>27</sup> *CIT Financial Ltd. v. R.*, 2004 FCA 201 at para 13.

<sup>28</sup> CRA, Views, Conference, “2010-0373401C6-T – Trusts and Addition of a Beneficiary” (Unofficial Translation) (8 October 2010).

<sup>29</sup> *Henderson Estate v. Minister of National Revenue*, [1973] C.T.C. 636 at para 21, 73 D.T.C. 5471 (“*Henderson Estate*”).

<sup>30</sup> *Carr v. The Queen*, 2004 TCC 434 at para 30 (“*Carr*”).

between knowledgeable, informed and prudent parties acting at arm's length, neither party being under any compulsion to transact.”<sup>31</sup>

In the *Wise Article*, the author notes of discretionary family trusts that:

As with other types of assets, the bottom-line test of the FMV of an income interest or capital interest in a discretionary trust is, "what would an informed and prudent arm's-length party, who is uncompelled to transact, pay for a life interest or reversionary interest?" Since there is no definitive economic interest in the income or capital of the trust (unless the vendor of the trust interest happens to be the sole beneficiary), the FMV of an interest in a discretionary trust would have, at best, "speculative value" and can be next to nil.<sup>32</sup> (Emphasis added).

In other words, it would be extremely difficult to find a willing buyer for an interest in a discretionary trust in respect of which no distributions may ever be made. This creates unique issues relating to the valuation of a beneficiary's interest in a discretionary trust. The entitlements of potential beneficiaries of a discretionary trust cannot be ascertained at the time of settlement,<sup>33</sup> nor at the time of a potential purchase. Depending on the terms of the trust in question, additional beneficiaries may be added over time (and distributions made to these newly added beneficiaries). Furthermore, the trustees may exercise their discretion so as to distribute all, a portion or none of the trust property to any given beneficiary. The management by the trustee of the trust property over time may result in the enhancement or diminishment of the value of the trust assets available for distribution over time. This is leaving aside the fact that, due to the personal nature of beneficial interests in discretionary trusts the interests may, themselves, be inalienable. How, then, can an interest in a discretionary trust be valued?

(i) The CRA's Position

At the 1992 BC Tax Conference, Finance noted that:

The fair market value of an interest (either income or capital) in a fully discretionary trust is, generally, indeterminable due to the discretionary power of the trustee.<sup>34</sup>

This is consistent with the position taken by the CRA in Interpretation Bulletin IT-226R (now archived), wherein it noted that:

The method of valuing a residual interest in real property or an equitable interest in a trust, whether it be for the purpose of determining the amount of a charitable donation or other tax consequences, will vary according to the type of gift, other interests in the

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<sup>31</sup> CRA, Information Circular IC89-3, "Policy Statement on Business Equity Valuations" (25 August 1989) at para 3.

<sup>32</sup> *The Wise Article*, *supra* note 11 at 30:14.

<sup>33</sup> *Purtzki v. Saunders*, 2016 BCCA 344 at para 67 ("*Purtzki*").

<sup>34</sup> CRA, Views, "9213470 – Fair Market Value of an Interest in a Fully Discretionary Trust" (September, 1992).

property or trust and the documentation providing for the gift. The general approach is to value the various interests taking into consideration the fair market value of the property itself, the current interest rates, the life expectancy of any life tenants, and any other factors relevant to the specific case. (Emphasis added).<sup>35</sup>

The CRA concluded that:

In cases where the size of a residual or equitable interest at the time of the donation cannot reasonably be determined, such as when a life tenant or trustee has a right to encroach on the capital of the trust, no deduction or tax credit in respect of the donation will be allowed.<sup>36</sup>

Subsequently, however, the CRA indicated that, while it is difficult to quantify the value of such an interest, “[i]t would be unreasonable to conclude that the FMV of an interest in a discretionary trust holding property with significant value has no value simply because it is difficult to measure.”<sup>37</sup> Instead, the CRA noted that, in the absence of a term in the trust directing the trustees to favour one beneficiary, “the even handed principle would suggest that [the] value of each beneficiary’s interest was approximately equal” and that “the value of each Beneficiary’s interest in Subject Trust...will approximate a proportionate share of the fair market value of the total of Subject Trust’s property at that time”.<sup>38</sup> The CRA went on to state that, where one beneficiary has a lesser chance of receiving a distribution than another, “it may be appropriate to discount the value of one interest and increase the value of another”.<sup>39</sup>

The CRA subsequently cited the approach taken in the family law decision of *Sagl v. Sagl*<sup>40</sup> (namely, the valuation of the interests of the beneficiaries as if the trust assets had been fully distributed among them on a *pro rata* basis) as being a “reasonable approach to take in many cases involving the valuation of an interest in a discretionary trust.”<sup>41</sup> As we will discuss in this paper, *Sagl* was decided on the basis of a *pro rata* approach to determining fair value (which is used for the purpose of dividing assets for family law purposes in jurisdictions where the relevant legislation permits this method) and not on the basis of fair market value.

(ii) *Sagl, Lang-Newlands* and Fair Value

The need to value an interest in a discretionary family trust has arisen with some frequency in the family law context. This is because, on termination of a marriage, one party is often motivated to have a value assigned to the interest in the discretionary family trust so that they may either share

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<sup>35</sup> CRA, Interpretation Bulletin IT-226R, “Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in Trust (29 November 1991) at para 5.

<sup>36</sup> *Ibid* at para 6.

<sup>37</sup> CRA Views, Ruling, “2001-0111303 – Beneficiary Added to Discretionary Trust” (2002).

<sup>38</sup> *Ibid*.

<sup>39</sup> *Ibid*.

<sup>40</sup> *Sagl v. Sagl*, [1997] O.J. No 2837, 31 R.F.L. (4<sup>th</sup>) 405 (“*Sagl*”).

<sup>41</sup> CRA Views, Technical Interpretation (External), 2003-0181465 – Fair Market Value of an Interest in a Discretionary Trust (April 3, 2003).

in it or be granted a greater portion of the remaining assets of the couple. The other party (that is the party that is a beneficiary of the discretionary family trust in question) will often resist such a finding. In family law, the courts have typically favoured the fair value methodology over fair market value for the purposes of valuing interests in discretionary trusts. Fair value has been described as the “value that is just and equitable in the circumstances.”<sup>42</sup> As noted in *Financial Principles of Family Law*:

In valuing an interest in a trust, the Ontario and B.C. courts have held that fair value is the most appropriate value definition, in particular, the use of a value to owner as being a “fair value” (see *Brinkos v. Brinkos*, *DaCosta v. DaCosta* and *Sagl v. Sagl*). If the owner is unable to transfer his or her interest to another party or if there is no “market” for the interest, then under a more rigid definition, such as fair market value, there may be no value to the asset.<sup>43</sup>

The “value to owner” method requires that the Court determine the value that a beneficiary would be prepared to pay in order to retain his or her interest in a trust. This approach was utilized by the Court in *Tremblay*, where Mr. Tremblay was the trustee of the discretionary trust in question as well as a beneficiary and the person able to appoint trustees. He therefore had full control over the distribution of funds from the trust. As Mr. Tremblay was able to control distributions from the trust, the uncertainty inherent in many discretionary family trusts was not present. The Court therefore determined that Mr. Tremblay would be willing to pay one dollar for every dollar of trust property held by the Trust, less the tax associated with the realization of the distributions, to retain his interest in the trust. A similar decision was reached by the Court in *Mudronja v. Mudronja*.<sup>44</sup>

The *pro rata* distribution approach utilized in *Sagl* (and favoured by the CRA) is also used in an attempt to ascertain fair value. However, this approach provides for the deemed realization of the value of the trust assets among all of the capital beneficiaries of a trust to determine the value of each beneficiary’s interest. Contingent income taxes are then deducted.

A review of the facts in *Sagl* assists with understanding the genesis of the *pro rata* distribution approach. In *Sagl*, the husband was the initial trustee of the Sagl Family Trust and was a beneficiary, together with his three sons from a prior marriage and their issue. Mr. Sagl had the power to appoint and remove trustees. The trustees had absolute discretion and could make decisions by majority, provided that Mr. Sagl was in the majority. Mr. Sagl eventually resigned as trustee for tax reasons.

During the acrimonious legal battle between Mr. and Mrs. Sagl on termination of their marriage, the Court was required to determine the value of Mr. Sagl’s interest in the Sagl Family Trust for

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<sup>42</sup> Lorne H. Wolfson: *Sagl v. Sagl: Valuation of an Interest in a Discretionary Trust Under Ontario’s Family Law Act*, 16 Canadian Family Law Quarterly, page 521, cited in *Kachur v. Kachur*, 2000 ABQB 709.

<sup>43</sup> Andrew Freedman, Christine Sawchuk and Timothy Martin, *Financial Principles of Family Law* (Toronto: Thomson Reuters, 2001) (loose-leaf updated 2023, release 4), vol 3 at 29-2 (“*Financial Principles of Family Law*”).

<sup>44</sup> *Mudronja v. Mudronja*, 2014 ONSC 6217 (“*Mudronja*”).

inclusion in Mr. Sagl's net family property. Counsel for Mrs. Sagl suggested a full inclusion of the value of the common shares held by the trust in the net family property calculation of Mr. Sagl, while counsel for Mr. Sagl suggested a "compromise"; namely, that the assets of the Sagl Family Trust be treated as if there had been a deemed realization amongst all capital beneficiaries as of the date in question. Contingent income taxes would then be deducted to arrive at the value to be attributed to Mr. Sagl.

The Court accepted Mr. Sagl's suggestion and included Mr. Sagl's *pro rata* interest in the Sagl Family Trust (adjusted for contingent income taxes) in calculating his net family property. To be clear, the Court in *Sagl* was not attempting to determine the fair market value of the interest in question. The Court referred to the deemed realization as a "compromise" which it determined provided the fairest and most equitable result. Importantly, the *Family Law Act*, R.S.O., c. F.3 (the "Ontario FLA") under which *Sagl* was decided did not require that equalization be made on the basis of fair market value.

It is of note that the analysis in *Sagl* was limited to its facts and not accepted by the Court in *Dillon v. Dillon*, which noted that:

*Sagl* cannot be considered as establishing new legal principles on trust law. The methodology employed was used to resolve the issues but, in my view, was contrary to accepted principles. *Sagl* has not been followed in subsequent cases.<sup>45</sup>

In *Lang-Newlands v. Newlands*,<sup>46</sup> however, Sharma J. favoured the *pro rata* division proposed in *Sagl*, coupled with a minority discount in valuing a beneficiary's interest in a family trust.

The parties in *Lang-Newlands*, Barbara Lang-Newlands ("Barb") and Ian Newlands ("Ian"), married in 1987 without a marriage contract. Barb's father, Gordon Lang, then owned all of the common shares of Connecticut Chemicals Limited ("CCL"), which were eventually transferred to a numbered company (such company and all successor companies referred to as "Holdco") owned by Gordon. In 1977, Gordon settled a trust (the "BJL Trust") of which Barb was the sole beneficiary.<sup>47</sup> Trusts were also created for Gordon's three other children (Don, Stuart and Sherry). The trustees of the B JL Trust (Gordon and two other parties) acquired 90 of the 450 issued and outstanding shares of Holdco (while the trusts created for Barb's siblings acquired similar interests in Holdco). Gordon retained voting control of Holdco.

Gordon had a health scare and decided to distribute the shares prior to the 21<sup>st</sup> anniversary of the B JL Trust. Consequently, Barb received the shares of Holdco previously held by the B JL Trust as a distribution during the marriage. Gordon and his four children, Holdco and another related company entered into a Transfer of Share Ownership Agreement agreeing, among other things,

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<sup>45</sup> *Dillon v. Dillon*, 2014 ONSC 2236 at para 289 ("*Dillon*").

<sup>46</sup> *Lang-Newlands v. Newlands*, 2024 ONSC 6285 ("*Lang-Newlands*"). We note that *Lang-Newlands* is currently under appeal.

<sup>47</sup> Gordon also created trusts for his three other children at around the same time.

not to sell, transfer or otherwise encumber their shares of Holdco without the consent of the other parties.

Gordon died in 2001. At that time, Don and Stuart became the owners of the corporation (the “Control Corporation”) that exercised voting control of Holdco and CCL. In 2001, prior to his passing, Gordon settled the Newlands Family Trust (“NFT”) for the benefit of Barb and her four children with an initial settlement of \$100. Don, Stuart and Barb were the trustees of the NFT. The NFT was a discretionary trust but prohibited distributions to minor beneficiaries. Decisions were to be made by a majority of trustees.

A new holding company, WSHJ Holdings Ltd. (“4MK”) was incorporated and shares were issued to the NFT. Barb was the sole director of 4MK. 4MK purchased Barb’s shares of Holdco in exchange for preferred shares in the capital of 4MK valued at \$24.48 million. Barb’s ability to sell 4MK’s shares was subject to the Transfer of Share Ownership Agreement and, therefore, required the consent of the Control Corporation.

Sharma J. considered whether Barb’s interest in the NFT constituted “property” within the meaning of s. 4(1) of the *Family Law Act*, R.S.O. 1990, c. F.3. (the “Ontario *FLA*”). The Court noted that the definition of “property” in the Ontario *FLA* is broad and includes “any interest, present or future, vested or contingent, in real or personal property.” Barb argued that her interest in the NFT was uncertain and produced authority including *Metro Vancouver* and *Spencer v. Riesberry*<sup>48</sup> in support of her argument that her interest did not qualify as “property”. Of *Metro Vancouver*, the Court noted that the analysis related to the word “asset” within the Assistance Application and noted that the definition of “property” in the Ontario *FLA* is broader. Sharma J. then cited cases including *Sagl, Kushnir v. Lowry*<sup>49</sup> and *Mudronja* for the proposition that an interest in a discretionary trust is an interest in property and concluded that Barb’s interest in the NFT is “property” and not excluded merely because it is discretionary.<sup>50</sup> Having so concluded, the Court went on to note that “...Barb is both a beneficiary and trustee, with a power of appointment with her brothers to make a distribution in her favour, and she has in fact received substantial distributions from the NFT. With these facts, it would be inconsistent with the broad definition of “property” in s. 4(1) of the *FLA* to not include as “property” Barb’s interest in the NFT.<sup>51</sup>

Sharma J. then considered whether Barb’s interest in the NFT was excluded from net family property because it represented a gift acquired during marriage. To this end, Sharma J. noted that he was bound by the finding in *Shinder v. Shinder*<sup>52</sup> to exclude Barb’s interest in the NFT.<sup>53</sup>

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<sup>48</sup> *Spencer v. Riesberry*, 2012 ONCA 418 (“*Spencer*”). We note that the Court in *Spencer* held that, unless the terms of the trust provide otherwise, a beneficiary has no property interest in any specific asset of the trust. However, this is different than arguing that a beneficiary has no property interest in the trust itself.

<sup>49</sup> *Kushnir v. Lowry*, [2004] O.T.C. 133.

<sup>50</sup> *Lang-Newlands*, *supra* note 46 at para 206.

<sup>51</sup> *Ibid* at para 221. Note, however, that the Court later rejects the inference that Barb controls the NFT, noting that it was Don who was the directing mind of the NFT.

<sup>52</sup> *Shinder v. Shinder*, 2018 ONCA 717 (“*Shinder*”).

<sup>53</sup> *Lang-Newlands*, *supra* note 46 at para 243.

However, he held that, if *Shinder* is not binding, he would find that Barb's beneficial interest in the NFT is not excluded property (though Gordon's initial gift of \$100 may be).<sup>54</sup>

The Court then considered what the value of Barb's interest in the NFT would have been on the date of separation. The NFT held 100 common shares of 4MK which, in turn, held 78 common shares of Holdco. The Court noted that "[t]he experts agreed that the gross value of 4MK's ownership of [Holdco] shares was \$668.7M."<sup>55</sup> Barb, who was one of the five beneficiaries of the NFT, argued that a *pro rata* distribution would be appropriate. Ian, on the other hand, argued that the full value of the NFT should be included as Barb's property on the basis that Barb was one of three trustees, that the trustees acted in concert, that Barb had received the vast majority of distributions from the NFT and that her requests for distribution were never denied.<sup>56</sup>

The Court noted that the *pro rata* approach had been utilized in several cases (including *Sagl* and *Kushnir*) and that it was appropriate in the case at hand. Sharma J. noted that the NFT distributions to Barb had not been for her sole and exclusive benefit; rather, the interests of other beneficiaries were also considered. Furthermore, 82% of the distributions were made as a result of decisions made by Don (and not in response to requests from Barb). He therefore rejected the inference that Barb controlled the NFT. The Court further rejected the suggestion that Barb had *de facto* control as a result of her directorship of 4MK. The Court concluded that "[i]t was Don who was the directing mind of the NFT as trustee", noting that "[i]n this role, the principle of equal distribution among beneficiaries governed."<sup>57</sup> Sharma J. therefore assigned 20% of the value of the NFT to Barb. This represents her *pro rata* share as one of five beneficiaries of the NFT.

Sharma J. then considered whether a minority / liquidity discount should apply to Barb's *pro rata* allocation. He noted that Barb did not control the NFT and its indirect investment in Holdco. While Barb controlled 4MK, she could not unilaterally exercise control of Holdco. Furthermore, Don and Stuart's permission would be required for 4MK to sell any of its shares of Holdco. 4MK owned roughly 1/3 of the equity of Holdco but only 4% of the votes. The Court noted that:

This is a significant factor underlying the rationale for a minority discount. What purchaser would be interested in purchasing an asset valued in excess of \$600M to only have 4% of the vote?"<sup>58</sup>

The Court did not find that Barb, Don and Stuart acted in concert to exercise control over their mutual investment and held that they were not likely to dispose of their collective interests

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<sup>54</sup> *Ibid* at para 313.

<sup>55</sup> *Ibid* at para 332.

<sup>56</sup> The positions taken by the parties in *Lang-Newlands* were very similar to those taken by the litigants in *Sagl*. In *Sagl*, the beneficiary spouse had argued in favour of a *pro rata* division while the opposing spouse had advocated in favour of a 100% inclusion of the value of the trust property.

<sup>57</sup> *Lang-Newlands*, *supra* note 46 at para 395.

<sup>58</sup> *Ibid* at para 418.

together. As such, Sharma J. stated that “I would find that a 50% minority / liquidity / blockage discount should apply to Barb’s 20% interest in the NFT.”<sup>59</sup>

In calculating Barb’s 20% proportionate interest (after the minority discount had been applied), the Court agreed to add back all prior distributions made by the NFT, determine Barb’s *pro rata* share of the NFT and then deduct actual distributions made to Barb. The argument was that “if you are dividing something into five pieces, if a person has already received a large part of their share under this scenario, they wouldn’t then be entitled to 20 percent of the remainder.”<sup>60</sup> The Court stated that this approach was consistent with the principle of treating all beneficiaries equally and, therefore, calculated Barb’s notional interest in the trust as follows:

|             |   |
|-------------|---|
|             | Value of the underlying assets                                    |
| Less        | 50% minority/liquidity discount                                   |
| Less        | contingent taxes on unrealized gains and other liabilities of 4MK |
| add back    | prior distributions to all beneficiaries to date of separation    |
| multiply by | 20% (to reflect Barb’s <i>pro rata</i> share)                     |
| Less        | distributions to Barb to date of separation                       |

The approach to valuing an interest in a discretionary trust in *Lang-Newlands* is thoughtful and novel. However, it appears to ignore some important corporate and trust law principles.

Minority discounts are typically applied at the corporate level. Sharma J. appeared to be aware of this as he noted in his decision that “a minority discount, or a discount for an absence of control of a corporation, is a valuation principle when valuing a shareholder’s interest in a corporation.”<sup>61</sup> Many of his comments in this respect do, indeed, relate to the corporate interests held by the NFT. For example, he noted that 4MK holds a mere 4% of the voting rights in respect of Holdco, which would affect its value to a purchaser. This fact, together with the fact that that 4MK is unable to sell its shares in Holdco without the consent of Don and Stuart, would rightly impact the value of 4MK. It may therefore be reasonable to apply a marketability discount to 4MK.<sup>62</sup> It is not, however, correct to apply a minority / liquidity discount to the interests of the beneficiaries of the NFT. Practically speaking, interests in trust may not be marketable at all. There are often restrictions on alienation and, generally speaking, no buyers for such interests. As such, if a marketability discount was to be applied to an interest in a discretionary trust, it would likely be close to 100%.

<sup>59</sup> *Ibid* at para 528.

<sup>60</sup> *Ibid* at para 536.

<sup>61</sup> *Ibid* at para 409.

<sup>62</sup> Indeed, this appeared to be what Paula White, a valuator engaged by Barb, was proposing to the Court. See *Lang-Newlands*, *supra* note 46 at para 532. It is of note that, in this case, minority discounts in respect of the CCL shares had already been worked into the share price (as CCL was publicly traded), but had not been worked into the valuation of 4MK.

Also problematic is the concept of adding back prior distributions (prior to calculating a *pro rata* share). In a typical discretionary family trust, there is no requirement that beneficiaries receive equal distributions over time. Barring anything to the contrary in the trust deed, receipt of distributions from the NFT would not disentitle Barb from receipt of future distributions in any amounts or proportions that the trustees consider appropriate. On the contrary, patterns of distributions to a beneficiary (especially to the exclusion of others) has been considered a factor that *increases* the value of the receiving beneficiary's interest.<sup>63</sup>

Further complicating matters is the fact that the Court had previously noted that the NFT distributions to Barb had not been for her sole and exclusive benefit; rather, the interests of other beneficiaries were also considered. At paragraph 348, the Court notes:

Don testified that he recognized that when distributions were made to Barb, they benefited the children who were minors for much of this period. I am satisfied that Ian and Barb spent these funds on the children, and in particular, millions on horses for Wesley who is an accomplished equestrian. In 2017, Barb also began paying quarterly allowances from funds she received – \$50,000 for Ian and \$25,000 to each of the children. Barb also spent funds she received on properties the family enjoyed and on debt. Following separation, Barb purchased two condos for the children.

If the distributions to Barb had been for the benefit of multiple beneficiaries, it is hard to see why the distributions should be deducted from Barb's *pro rata* share.<sup>64</sup>

*Lang-Newlands* may be cited by some as authority for the proposition that the *Sagl* method is a valid approach for determining the value of interests in discretionary trusts. However, a contrary view may also be taken. The Court in *Lang-Newlands* began with the *Sagl* *pro rata* distribution, but was required to make significant adjustments to arrive at a value that it considered to be fair and equitable in the circumstances. This suggests that the *Sagl* approach, taken alone, cannot be relied upon to arrive at a fair and equitable result.

If the *pro rata* approach is not reliable, what approach should be taken in determining the value of an interest in a discretionary trust for family law purposes? Valuers often favour the value-to-owner methodology for determining fair value. Where there is no market for an interest, utilizing the fair market value may lead to the most objective result but, for the purposes of a

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<sup>63</sup> This is easily understood if one considers how the Court's calculation would apply to one of the other beneficiaries (that is, Barb's children) if they were involved in identical litigation. Their *pro rata* interests would be *increased* as a result of the fact that distributions had been made to Barb over time. This is despite the pattern of repeat distributions to Barb over the other beneficiaries and despite the fact that Barb is the only one of the beneficiaries that is also a trustee.

<sup>64</sup> This decision to treat prior distributions in this manner had a material impact on the value of Barb's notional interest in the NFT. The *en bloc* value of 4MK agreed upon was \$668.7M. The prior trust distributions to the date of separation totalled \$36,471,215 of which \$33,401,015 were allocable to Barb. Barb's distributions were equal to roughly 5% of the *en bloc* value of 4MK. Adding these distributions back before computing Barb's 20% interest and deducting them from her *pro rata* share resulted in a reduction of roughly 45% of her *pro rata* interest.

family dispute, it may result in significant unfairness. As noted in *Financial Principles of Family Law*:

In general, the courts have favoured the use of “fair value” in family law contexts over the use of a fair market value definition. The use of fair value is particularly appropriate in cases involving trusts because the fair market value definition requires that the asset be commercially transferable and marketable. Trust interests are generally not marketable and there are severe restrictions on transferability. Therefore, applying a fair market value definition to value a contingent interest would mean the interest would have no value.<sup>65</sup>

Where determining the fair value of an interest in a discretionary trust has proven difficult, the courts have sometimes used the “if and when approach” to assist with the division, which requires the parties to wait and see if distributions are made to the beneficiary spouse. In *Grove v. Grove*, the Court ordered that the interest in the Grove Trust would be divided 80% to Mr. Grove and 20% to Mrs. Grove; however, the value of the interest would be the net amount received by Mr. Grove when the capital assets of the trust were distributed.<sup>66</sup> Similarly in *Fulton v. Gunn*, the Court noted that the beneficiary spouse had been disinherited but provided that, should he receive a distribution from the Sally Gilson Trust, he would be obligated to make a payment to his spouse.<sup>67</sup> The “if and when approach” is not a valuation methodology as much as a mechanism for dividing trust distributions between parties.

Whereas the B.C. courts have traditionally used fair value methodologies to value interests in discretionary trusts in the context of family disputes, this may no longer be appropriate for disputes arising under British Columbia’s new family legislation.

- (iii) British Columbia’s *Family Law Act*, S.B.C. 2011, c. 25 and Fair Market Value

Prior to March, 2013, the *Family Relations Act*<sup>68</sup> (“*FRA*”) governed the division of assets on dissolution of a marriage in British Columbia.

Paragraph 58(3)(a) of the *FRA* specifically provided that, where a trust owned property that would be a family asset if owned by a spouse (instead of by the trust), the spouse’s interest in the trust would be considered to be a family asset. Paragraph 58(3)(b) of the *FRA* further stated that property over which a spouse had a power of appointment exercisable in favour of him or herself would constitute a family asset where the underlying property would be a family asset, were it owned by the spouse.

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<sup>65</sup> *Financial Principles of Family Law*, *supra* note 43 at 29-8.

<sup>66</sup> *Grove v. Grove*, [1996] B.C.J. No. 658 at para 86, [1996] B.C.W.L.D. 1095 (“*Grove*”).

<sup>67</sup> *Fulton v Gunn*, 2008 BCSC 1159 at para 159 (“*Fulton*”). See also *George v. George*, [1983] 5 W.W.R. 606, 140 D.L.R. (3d) 486.

<sup>68</sup> *Family Relations Act*, RSBC 1996, c.128 (“*FRA*”).

A key issue in determining whether an interest in a discretionary family trust was a “family asset” under the *FRA* was whether the trust was used for family purposes.<sup>69</sup> Where an interest in a discretionary family trust was found to be a family asset, it was subject to apportionment by the court. Factors considered by the court in reapportioning trust interests included “the unpredictability of the demise of the older generation; the fact that the beneficiary may predecease a date when any distributions would be made; the fact that there was no certainty with respect to the proportion of distribution among the beneficiaries; and tax uncertainties.”<sup>70</sup>

The *Family Law Act* of British Columbia came into effect on March 18, 2013.<sup>71</sup>

Broadly speaking, the *FLA* provides that both spouses are entitled to family property and are responsible for family debt, regardless of their respective use or contribution (unless an agreement or order provides otherwise).<sup>72</sup> As a starting point, therefore, it must be determined whether a given property (including an interest in a discretionary trust) constitutes family property.

Subsection 84(1) of the *FLA* provides that, subject to section 85, family property is all real and personal property that was owned by at least one spouse or that constitutes “a beneficial interest of at least one spouse in property” (collectively, the “Level One Property”) on the date of separation. Real and personal property acquired by at least one spouse derived from Level One Property and beneficial interests acquired by at least one spouse derived from (or from the disposition of) Level One Property also constitute family property. Subsection 84(2) of the *FLA* sets out a number of assets that are specifically included as family property. Among these inclusions are:

- “property, other than property to which (3) applies, that a spouse disposes of after the relationship between the spouses began, but over which the spouse retains authority, to be exercised alone or with another person, to require its return or to direct its use or further disposition in any way”: *FLA*, paragraph 84(2)(f). An example of this provision being applied is where, during the course of the relationship, a spouse transferred real estate to a discretionary trust of which he was the settlor, one of two trustees and a beneficiary.<sup>73</sup>
- “the amount by which excluded property has increased since the later of the date the relationship between the spouses began or the excluded property was acquired”: *FLA*, paragraph 84(2)(g). In other words, while excluded property is not divisible, growth in the value of excluded property from the later of the date the relationship between the

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<sup>69</sup> See *Hart v. Hart*, 2012 BCSC 334 and *V. (L.S.C.M.) v. V. (D.W.E.)*, 2012 BCSC 1734.

<sup>70</sup> Christine Murray and Kendra Marks, “Valuing Discretionary Trust Interests” in *Hot Topics in Family Law: Navigating the Financial Landscape* (Victoria: CLEBC, 8 June 2018) at 2.2.5 (“*Valuing Discretionary Trust Interests*”), citing *Grove*, *supra* note 66.

<sup>71</sup> *Family Law Act*, S.B.C. 2011, c. 25 (“*FLA*”). The *FLA* was passed on November 23, 2011 and received Royal Assent on November 24, 2011. The key provisions of the *FLA* were brought into force on March 18, 2013 pursuant to BC Regulation 131/2012.

<sup>72</sup> *Ibid* at subsection 81(1).

<sup>73</sup> *M.C.V. v. F.V.*, 2018 BCSC 96 (“*M.C.V.*”).

spouses began and the date the excluded property was acquired (the “Term”) is considered to be family property and, therefore, divisible. Subsection 84(2.1) of the *FLA* notes that, for the purposes of paragraph 84(2)(g), “any increase in value of a beneficial interest in property held in a discretionary trust does not include the value of any property received from the trust”.

Subsection 84(3) of the *FLA* notes that,

despite subsection (1) and subject to paragraph 85(1)(e), family property includes that part of trust property contributed by a spouse to a trust in which

- (a) the spouse is a beneficiary, and has a vested interest in that part of the trust property that is not subject to divestment,
- (b) the spouse has a power to transfer to themselves that part of the trust property<sup>74</sup>, or
- (c) the spouse has a power to terminate the trust and, on termination, that part of the trust property reverts to the spouse.

Subsection 84(3) will apply where a spouse transfers property to a trust in circumstances where the spouse has the ability to cause the property to revert to them (whether by way of a transfer or by terminating the trust) or retains a vested interest in it. Section 85 of the *FLA* sets out a number of exclusions from family property (“Excluded Property”). To the extent that property qualifies as Excluded Property, it will not constitute family property (even if it may otherwise appear to fall into an inclusion under section 84). Excluded property, for the purposes of the *FLA*, includes:

- “property acquired by a spouse before the relationship between the spouses began”: paragraph 85(1)(a).
- “property referred to in paragraphs 85(1)(a) through (d) held in trust for the benefit of a spouse”: paragraph 85(1)(e). This signifies that property acquired by a spouse before the relationship that is subsequently moved into a trust will not lose its status as excluded property.
- “a spouse’s beneficial interest in property held in a discretionary trust to which the spouse did not contribute, and that is settled by a person other than the spouse”: paragraph 85(1)(f). This would include interests held by beneficiaries in discretionary trusts settled, for example, by their parents for the benefit of their Issue.<sup>75</sup>

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<sup>74</sup> It is of note that, while paragraph 84(2)(f) specifically includes situations where the spouse retains authority over the property to be exercised alone or with another person, there is authority to suggest that, when acting with one or more additional trustees, a trustee does not have the requisite power to transfer property to themselves for the purposes of s. 84(3). See *W. (S.L.M.) v. W. (M.R.G.)*, 2016 BCSC 272.

<sup>75</sup> It is of note that trusts that are not truly discretionary in nature may not qualify as excluded property under subparagraph 85(1)(f) of the *FLA*. See *Negus v. Yehia*, 2018 BCSC 604 (“*Negus*”).

A review of these provisions makes it clear that, while a spouse's interest in a s. 85(1)(f) discretionary trust (referred to simply as a discretionary trust for the balance of this discussion) may constitute Excluded Property pursuant to paragraph 85(1)(f) of the *FLA*, the increase in the value of the spouse's interest during the Term will constitute family property.

Subsection 87 of the *FLA* provides that, unless an agreement or order provides otherwise and except in relation to a division of family property under Part 6, the value of family property must be based on its fair market value. This is a departure from the *FRA* and other family legislation which, typically, is silent on the valuation methodology to be employed. As a starting point, therefore, the courts in British Columbia are now required to look to the fair market value of assets (including interests in discretionary trusts) in dividing assets between parties.

Subsection 95(1) of the *FLA* allows the Supreme Court to order an unequal division of family property if it would be significantly unfair to divide it equally. However, the fact that family property may be divided unequally should not affect the valuation methodology to be employed. Section 96 of the *FLA* also allows for the division of excluded property where family property or debt outside British Columbia cannot practically be divided or it would be significantly unfair not to divide excluded property. However, it is of note that the *FLA* contains no provision similar to section 87 requiring excluded property to be valued based on its fair market value, should section 96 be invoked.

The introduction of the requirement that family property (including the increase in value of excluded interests in discretionary trusts over the Term) be valued at fair market value has caused no shortage of difficulty for the Courts. Justice Skolrood in *Stober v. Stober* noted that:

The challenge in this case...is that the principles and methodologies are not well-known or established. There is no clear jurisprudence that guides the court or the expert in approaching the issue of value...It is not clear to me that the concept of fair market value, which is the central question to be posed...even has any meaning or application to beneficial interests in a discretionary trust...<sup>76</sup> (Emphasis added)

The growth in the value of an interest in a discretionary trust was recently considered by the British Columbia Court of Appeal in *Cottrell v. Cottrell*.<sup>77</sup>

Paul and Joanne Cottrell married in 1995. In 2010, Joanne's parents, Robert and Patricia Muster, established the Robert and Patricia Muster Family Trust (the "Muster Family Trust"). The original trustees under the Muster Family Trust were Robert, who was primarily responsible for managing the trust assets and considered himself to have full discretion over the distribution of the assets, and Patricia. The beneficiaries under the Muster Family Trust were Robert, Patricia, their two children, Bruce and Joanne, and every child born to or adopted by Bruce and Joanne.

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<sup>76</sup> *Stober v. Stober*, 2015 BCSC 2505 at para 38 ("*Stober*").

<sup>77</sup> *Cottrell v. Cottrell*, 2023 BCCA 471 ("*Cottrell*").

After Patricia died in 2012, Joanne and Bruce were also made trustees but did not take an active role in managing the assets.

The Muster Family Trust provided the trustees with complete discretion to appoint additional beneficiaries. The final distribution of the trust was set for September 1, 2031, however, the trustees were given discretion to terminate the trust earlier. At the time of final distribution, if Robert was still alive, the trustees would have discretion to unequally distribute the balance of the Muster Family Trust. If Robert was not alive, the balance of the Muster Family Trust would be divided equally between Joanne and Bruce. Prior to the time of final distribution, the trustees were given absolute discretion and power to pay out income or transfer assets out of the Muster Family Trust for the benefit of any one of the beneficiaries, unequally.

In 2017, Paul and Joanne separated and Joanne brought a family law claim. In the course of the action, Paul sought an order for division of the increased value in Joanne's beneficial interest in the Muster Family Trust.

On July 5, 2021, Joanne resigned as trustee to distance herself from the Muster Family Trust.

The trial judge found that given the contingent nature of Joanne's beneficial interest in the Muster Family Trust, there had been no increase in value over the course of Paul and Joanne's relationship. Joanne "never had the actual or even an apparent ability to compel a distribution of the [Muster Family Trust], and [had] no reliable assurance regarding the specific extent to which she may receive such a distribution in the future".<sup>78</sup>

The British Columbia Court of Appeal dismissed Paul's appeal, finding no error of law in the trial judge's interpretation of the *FLA*. The Court held that determining the increase in value of a beneficial interest in a discretionary trust requires consideration of both the trust instrument and the circumstances surrounding the trust's management and distribution. Rejecting Paul's suggestion that the *pro rata* approach adopted in *Sagl* be implemented as a matter of course, the Court indicated that there is no "one-size-fits-all formulaic approach to valuing a spouse's beneficial interest in property held in a discretionary trust".<sup>79</sup>

The Court acknowledged the difficulty in applying the concept of an open market for a beneficial interest in a discretionary trust. However, it noted that, under the *FLA*, the fair market value of an interest in a discretionary trust serves only as a starting point in the valuation process, leaving the courts free to adopt other approaches.<sup>80</sup> While the Court did not prescribe a specific method of valuation in this case, it noted that "it is conceivable that a chartered business valuator might be able to value Ms. Cottrell's beneficial interest in the [Muster Family Trust]".<sup>81</sup> The Court went on to explain that whether valuation is possible at all—and if so, how that value is to be determined—is a fact-specific inquiry, likely requiring expert evidence.<sup>82</sup>

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<sup>78</sup> *Ibid* at para 43.

<sup>79</sup> *Ibid* at para 61.

<sup>80</sup> *Ibid* at para 73, citing *Stober*, *supra* note 76 at para 35.

<sup>81</sup> *Ibid* at para 73.

<sup>82</sup>The Court cited *Financial Principles of Family Law* for a number of factors relevant in valuation of an interest in a discretionary trust including the circumstances of the owner-spouse, the trust, and the other beneficiaries, the number and ages of the various beneficiaries, the obligations of the trustee(s) under the terms of the trust, the owner-spouse's overall estate planning, the trustee's possible plans for the underlying assets of the trust, the obligation of

As previously noted, an interest in a discretionary trust is not family property for the purposes of the *FLA*. However, the growth in the value of an interest in a discretionary trust is family property and, therefore, of interest in a family proceeding. Looking to the legislation, the Court in *Cottrell* explained the process for determining the value of the growth in the value of Joanne's interest in the Muster Family Trust over the relevant period as follows:

Two values must be determined under s. 84(2)(g): the value of the spouse's beneficial interest at the later of the time the relationship began or the property was acquired; and the present value of the spouse's beneficial interest at the time of trial. The two values then need to be compared to determine if there has been growth in the value of that beneficial interest. A number of factors could potentially affect these starting and end values, including the uncertainties just mentioned.<sup>83</sup>

The Court of Appeal noted many uncertainties existed at the formation of the Muster Family Trust. These included:

...the life expectancy of Robert Muster; Robert Muster's future investment decisions managing the trust; the potential that the investments might decline in value due to market conditions or unsuccessful investment decisions, prior to any anticipated distribution of the same to beneficiaries; the potential future needs of Robert and Bruce Muster, including whether they might have special medical needs when they age that are not provided for by other means; any special needs of Ms. Cottrell's children, now and in the future; Ms. Cottrell's own future needs and life expectancy; and whether Robert Muster might change the terms of the trust or beneficiaries in the future.<sup>84</sup>

The Court of Appeal noted that these uncertainties had not diminished during the parties' marriage.<sup>85</sup> Having so concluded, the Court of Appeal dismissed the appeal and upheld the trial judge's finding that Joanne's interest in the trust had not increased during her relationship with Paul.<sup>86</sup>

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the trustee(s) to maintain an even hand when dealing with all beneficiaries, the fair market value of the underlying assets of the trust, and the expectations and legal rights of the other beneficiaries: *Ibid* at para 78, citing *Stober, supra* note 76 at para 32, citing Harold Freedman and Avra White, *Financial Principles of Family Law* (Toronto: Thomson Reuters, 1993) (loose-leaf) at 28-13-28-14.

<sup>83</sup> *Ibid* at para 77.

<sup>84</sup> *Ibid* at para 75.

<sup>85</sup> *Ibid* at para 76.

<sup>86</sup> *Ibid* at para 65. We note that fairness, which itself is closely tied to the certainty and expectation of distributions, may have been a factor in the Court's analysis. When a court attributes value to the increase in a spouse's interest in a discretionary trust, that value becomes immediately divisible between the spouses. Since the beneficiary has not yet realized the interest, the division would be offset against their share in other family property. In this case, the Court noted that "Ms. Cottrell would be starting out after a lengthy marriage, trying to establish a new career, with next to no assets and nothing but a possibility of receiving some assets from the [Muster Family Trust] in 2031.... Mr. Cottrell, on the other hand, would have no uncertainty about his financial future, having received all of the equity in the family home in compensation for Ms. Cottrell's uncertain future distribution from the trust.

It is interesting to note that a number of the factors at play in *Cottrell* could very well have resulted in an increase in the value of Joanne's interest. For example, Robert aged by 12 years between the establishment of the Muster Family Trust and the trial date. The Muster Family Trust was, itself, 12 years closer to the distribution date at the time of trial. A number of the changes that could theoretically have been made prior to that time had not been made. For example, Robert had not added additional beneficiaries in those 12 years (besides Joanne's children, who were added by virtue of their birth and not as a result of a positive act on Robert's part). Furthermore, the value of the underlying assets had increased significantly. In Paul's estimation, the value of the assets held by the Muster Family Trust increased by \$12,596,470.85 during the relevant period.<sup>87</sup> One would therefore assume that the likelihood that Joanne would receive a payment from the Muster Family Trust was higher on the date of trial than on the date on which the trust was established and that such payment, when received, would be of a much higher value. Nonetheless, the Court was of the view that the value of Joanna's interest had not increased during the relevant period.<sup>88</sup>

The Court of Appeal noted in *Cottrell* that "a chartered business valuator might be able to value Ms. Cottrell's beneficial interest in the [Muster Family Trust]".<sup>89</sup> However, many valuers take the view that as it is impossible to determine the value of a beneficiary's interest in a family trust or, indeed, that the fair market value of a beneficiary's interest in a discretionary trust is nil. This is especially true where there is no history of distributions being made and there are no facts suggesting control by the beneficiary over the making of distributions.

In *Cottrell*, the Court draws a clear distinction between the fair market value of an interest in a family trust and the fair market value of trust property. Despite the fact that the value of the assets of the family trust had appreciated materially during the period in question, the Court held that Joanne's interest had not. This is very much at odds with the position being taken by the CRA in reliance on *Sagl* (which, again, was decided on the basis of fair value and not on the basis of fair market value). The decision of the British Columbia Court of Appeal in *Cottrell*, combined with general valuation principles relating to the determination of fair market value, provide a strong basis for questioning the CRA's position and its reliance on *Sagl* for the purposes of valuing interests in discretionary family trusts.

#### (e) **Concluding Comments – Valuing an Interest in a Discretionary Trust**

The fair market value of an interest in a discretionary trust will depend on what a knowledgeable, informed and prudent arm's length party would be willing to pay to acquire it. By its very nature, an interest in a discretionary trust merely grants to its holder a right to be considered by the trustee for distributions. The beneficiary has no right to force distribution of the underlying

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<sup>87</sup> *Cottrell v. Cottrell*, 2022 BCSC 1607 at para 35 ("*Cottrell Trial Decision*").

<sup>88</sup> Presumably, if one were to purchase a lottery ticket (which, admittedly, carries a degree of randomness that would not be found in most family trusts), one may be willing to pay more for a ticket carrying a chance at a \$13 million payout than for a lottery ticket carrying a chance at a \$1 payout. Similarly, one may be willing to pay more for a lottery ticket where the winner would be drawn in 9 years than for a similar ticket where the winner would be drawn in 21 years. It may be, however, that one would be unwilling to pay anything for either ticket.

<sup>89</sup> *Cottrell*, *supra* note 77 at para 73.

property and has no control over when (if ever) any distributions will be made to him or her. The holding of an interest in a discretionary trust has been held not to “ameliorate in any meaningful way” the financial situation of a beneficiary before such time as distributions are made to them.<sup>90</sup>

As discussed above, the recent decision in *Cottrell* provides useful guidance on determining the fair market value of an interest in a discretionary trust. Notably, in *Cottrell*, the British Columbia Court of Appeal held that there had been no increase in the fair market value of the discretionary trust in issue. This was the case despite the fact that:

- Roughly 12 years elapsed between the time at which the Muster Family Trust was settled (September 14, 2010) and the time of trial (2022). Whereas, when Joanne received her interest in the trust, she could expect to wait 21 years (at most) to receive her share in the distribution of the trust (if it was forthcoming), this was no longer the case in 2022. At the time of trial, Joanne’s wait was roughly nine years in length.
- Robert was then in his eighties and had not disinherited Joanne in the twelve years that had elapsed.
- No beneficiaries had been added to the trust besides Joanne’s own children (by virtue of their births and not as a result of any actions taken by Robert pursuant to a power of appointment).
- The value of the underlying property (and, therefore, the approximate increase in value of the underlying assets during the period in question) was \$12,596,744.84 (per Paul).

These circumstances would, in theory, make an interest in the trust far more appealing to an arm’s length buyer.

In spite of these facts, the BC Court of Appeal concluded that Joanne’s interest in the trust had not increased between 2010 and 2022. The uncertainty surrounding her interest was too significant as she, like other beneficiaries of a discretionary trust, had no real interest in the property owned by the trust. Joanne had no right to force distributions to herself and had no control over when any such distributions would be made (though, again, the final distribution was to be made in 2031). Robert could make a bad investment and reduce the value of the assets held by the trust significantly. The logical conclusion of the Court’s decision is that Joanne’s interest in the trust, while more appealing, was not sufficiently certain to draw a willing buyer.

As previously noted, the CRA’s position with respect to the valuation of interests in discretionary trusts is difficult to support based on the jurisprudence (whether relating to trust law, family law or tax law). It is criticized by valuers (who largely appear to take the view that

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<sup>90</sup> *Metro Vancouver*, *supra* note 18 at para 49.

the fair market value of an interest in a discretionary trust is nil as there is no market for such interests). The position taken by these valuers is, in turn, supported by the decision in *Cottrell*.

It is the author's view that the fair market value of interests in discretionary trusts cannot be determined through the application of the *pro rata* approach adopted in *Sagl* and *Lang-Newlands*. Besides the fact that the *pro rata* approach was developed for a completely different purpose (that is, the determination of the fair value of interests in discretionary trusts), the approach does not take into account the flexible nature of trusts and the vast differences that can exist among discretionary trusts in Canada.

Two trusts may bear the title of "discretionary trust". However, the nature and extent of the discretion granted to the trustees in their respective trust deeds may be drastically different. The trust deeds may set out clear instructions as to how the trust property is to be used, how long it is to be held, how it is to be distributed, or it may be silent on such matters, leaving the determination of these issues to the trustee. The discretionary powers granted to the trustees may be broad or they may be subject to pre-determined limitations to which the trustees must adhere. The purposes for which the trusts were settled may differ.

Other differences may arise between the trusts over time. It may be that distributions are routinely made to some beneficiaries to the exclusion of others. It may also be that the trustee of one trust tends to pay out income generated by a trust over time whereas another retains the income in the trust, investing it in ventures of varying risk.

The circumstances of the beneficiaries of the two trusts may also differ. One trust may have young beneficiaries that cannot yet be trusted with significant wealth. Another trust may have mixed beneficiaries, including elderly beneficiaries that may not be expected to survive until the date on which the trust will have sufficient liquidity to make a distribution. Some beneficiaries may be wealthier than others. Some of the beneficiaries may have special needs or challenges. The response of the trustees to these differences may differ depending on the values and inclinations of the trustees.

In light of the flexible nature of trusts, attempting to determine the fair market value of an interest in a discretionary trust by way of a mechanical *pro rata* calculation will often lead to unfair and arbitrary results. Furthermore, it may allow for abuse as *pro rata* interests may be reduced by adding more beneficiaries to a discretionary trust at the outset, thereby reducing each beneficiary's *pro rata* share.

The courts have ruled that the fair market value of an asset is the highest price obtainable for the asset in an open and unrestricted market between knowledgeable, informed and prudent parties acting at arm's length, neither party being under any compulsion to transact. This price (and, therefore, the value of an interest in a discretionary trust) is likely nil.

That said, for the balance of this paper, we will assume that interests in discretionary trusts *may* have value. In many of the “traps” set out below, the result to the taxpayer (on a dollar basis) will depend upon the fair market value of the beneficial interest held. Should the courts find that interests in discretionary trusts have no value, some of these traps may lack teeth. However, until a determination is made one way or the other, we think it best to alert readers to these issues as, with the introduction of the enhanced trust reporting rules, it will likely become far easier for the CRA to catch those that unwittingly stumble into them.

### **3. Removal and Addition of Beneficiaries**

Where applicable, the enhanced trust reporting rules require trustees to provide personal information regarding beneficiaries to the Minister. A settlor need not inform a beneficiary before appointing them as such. Accordingly, beneficiaries (including contingent beneficiaries) may learn (for the first time, perhaps) of their beneficial interest in a trust when approached by the trustee for their personal information for the purposes of completing a Schedule 15.

In some cases, these beneficiaries may not wish to have any dealings with the trust or trustees. In other cases, they may object to sharing their personal information with the Minister (especially where they may be unlikely to receive a distribution from the trust in any event). They may have various other tax and non-tax reasons for preferring to opt out of participating in the trust.

In such circumstances, can a beneficiary cease to be a beneficiary? Will doing so trigger any adverse tax consequences for them or for the trust?

#### **(a) Removal of Beneficiaries of an Existing Trust**

Beneficiaries named as such in a trust deed (or will) are not compelled to remain as beneficiaries. As noted by Plowman J. in *Re Gulbenkian's Settlements Trusts (No. 2)*:

If a man cannot be compelled to accept a gift I see no reason why he should not be equally free to refuse to accept the exercise of a power which the donor has conferred on the trustees to make a gift in his favour...<sup>91</sup>

In *Benquesus v. The Queen*, the court held that a valid *inter vivos* gift requires that there be an intention to donate on the part of the donor, acceptance of the gift by the donee and a sufficient act of delivery.<sup>92</sup> The threshold for finding acceptance is not high and is often subject to a rebuttable presumption. The court in *Benquesus* also cited Professor Gillese's text, "Property Law", which indicates that:

In circumstances where the gift is beneficial to the donee, the Courts will normally presume acceptance by the donee. Thus, a valid gift can be made without the donee's

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<sup>91</sup> *Re Gulbenkian's Settlements Trusts (No. 2)*, [1970] 1 Ch. 408 at 418 (“*Re Gulbenkian's Settlements Trust (No.2)*”).

<sup>92</sup> *Benquesus v. The Queen*, 2006 TCC 193 at para 4 (“*Benquesus*”).

knowledge but is subject of the donee's right to unilaterally repudiate upon learning of the gift.<sup>93</sup>

The courts have consistently held that “intent and delivery by and of one party alone is insufficient.”<sup>94</sup> As such, where a beneficiary refuses to accept a gift, the gift cannot be completed, even where delivery has been effected.<sup>95</sup> In such circumstances, the transfer is void *ab initio*.<sup>96</sup>

The courts have held that a disclaimer requires no particular form and can be evidenced by conduct. They have further held that, though the disclaiming beneficiary cannot have received a benefit prior to disclaiming,<sup>97</sup> they also cannot validly disclaim until the entitlement arises.<sup>98</sup> Disclaimers must be made within a reasonable time after the beneficiary becomes aware of the interest<sup>99</sup> and cannot be made in favour of another person.<sup>100</sup> In determining whether an interest was validly disclaimed, the conduct of the disclaiming party may be relevant.<sup>101</sup>

In the 1959 Tax Appeal Board decision, *Plaxton v. Minister of National Revenue*,<sup>102</sup> a surviving spouse of an individual who died intestate received funds from the estate of his late father-in-law. He credited these funds to the estate of his late wife. While he would have had a claim to a portion of the funds by virtue of the laws of intestacy, he waived his rights to the funds and made them available to his three children. The Minister took the position that the surviving spouse’s renunciation did not amount to a valid disclaimer. In dismissing the taxpayer’s appeal, the Court noted that:

...the appellant not only received the money sent to him, but also assumed dominion over it to the extent of selecting or directing its further destination. While he chose the heirs who, after him, were next entitled to the money, this might better have been left to the executor of the Turner estate...<sup>103</sup>

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<sup>93</sup> *Ibid* at para 8.

<sup>94</sup> *Leclair v. R.*, 2011 TCC 323 at para 19 (“*Leclair*”).

<sup>95</sup> See *Leclair*, *supra* note 94 where property was conveyed by a father to his daughter without her knowledge or consent. Upon learning of the gift, the daughter repudiated the gift by conveying the property back to her father. The Court held that the transfer of the property back to the father constituted a valid disclaimer in respect of the gift.

<sup>96</sup> Though, notably, the court in *Gilbert v. Minister of National Revenue*, [1983] C.T.C. 2712 at para 9, 83 D.T.C. 645 held that a son could not cure a tainted spouse trust by disclaiming his right to receive capital during his mother’s life as the disclaiming beneficiary could not “by disclaimer or otherwise, . . . change the terms of the trust.”

<sup>97</sup> See *Bank of Nova Scotia v. Chan* (1987), 26 E.T.R. 180 at para 9, 68 C.B.R. (N.S.) 118 (“*Bank of Nova Scotia*”), where the court notes that “[t]he essence of a disclaimer is that the intended donee declines to take any benefit from the gift. If he receives a kickback for giving it up, he is taking a benefit from it, and, whatever name may be put on the document he signs, it would not in truth be a disclaimer but an assignment to the persons who would benefit by it.”

<sup>98</sup> *Biderman v. R.*, [2000] F.C.J. No. 194 at paras 11 and 12, 2000 D.T.C. 6149 (“*Biderman*”). We note that this case was decided in the context of a disclaimer of an interest in an estate.

<sup>99</sup> *Leclair*, *supra* note 94 at para 19.

<sup>100</sup> *Plaxton v. Minister of National Revenue*, 60 D.T.C. 38 at para 6, 23 Tax A.B.C. 257 (“*Plaxton*”).

<sup>101</sup> *Biderman*, *supra* note 98 at para 11.

<sup>102</sup> *Plaxton*, *supra* note 100.

<sup>103</sup> *Ibid* at para 9.

Care must therefore be taken to ensure that a disclaiming beneficiary not direct the parties to whom the disclaimed interest will fall, as exercise of any control over the interest may affect its taxability.

From a tax perspective, a valid disclaimer results in something of a “non event”. In other words, as the gift to the beneficiary is void *ab initio*, the beneficiary is treated as never having acquired the interest, and there is no disposition for tax purposes. As a result, there is no income inclusion or capital gain, and the disclaimer is, itself, not a taxable event.<sup>104</sup>

The CRA is in agreement with this analysis and notes that:

Generally, a disclaimer is an outright refusal to accept a gift or interest. A taxpayer who executes a valid disclaimer (not in favour of any person) of an income interest in a trust will be considered not to have acquired that income interest. Therefore, in such a situation, subsection 106(2) will have no application. To be a valid disclaimer the refusal must occur:

- within a reasonable time after the recipient becomes aware of the gift or interest; and
- before the acceptance of any funds or benefits in respect of the gift or interest.<sup>105</sup>

The CRA has confirmed that the principles set out in Interpretation Bulletin IT-385R2 (that is, the predecessor of Folio S6-F2-C1) also apply to capital interests (the reference to subsection 106(2) being replaced with a reference to section 40).<sup>106</sup>

Furthermore, as the gift is never accepted and is void *ab initio*,<sup>107</sup> subsection 160(1) of the *ITA* will not likely apply to the disclaimed interest, notwithstanding the broad interpretation of the term “transfer” by the judiciary over time.<sup>108</sup> Similarly, the courts have held that “a disclaimer does not fall within [the meaning of conveyance for the purposes of] the *Fraudulent Conveyances Act*, and therefore cannot be avoided by it.”<sup>109</sup>

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<sup>104</sup> Note that Subsection 248(8) of the *ITA* provides that a transfer, distribution or acquisition of property as a consequence of a disclaimer by a beneficiary under a will or on intestacy is considered to be a transfer as a consequence of death, and subsection 248(8)(c) specifically states that a release or surrender by a beneficiary with respect to property of the deceased immediately before death is not considered a disposition by the beneficiary.

<sup>105</sup> CRA, Income Tax Folio S6-F2-C1, “Disposition of an Income Interest in a Trust” (25 November 2025) at para 1.10.

<sup>106</sup> CRA, Views, “9506285 – Release / surrender income and capital interests” (7 July 1995).

<sup>107</sup> *Biderman*, *supra* note 98 at para 49.

<sup>108</sup> *Ibid*. We note that *Biderman* was decided in the context of a disclaimer of an interest in an estate. The disclaimer was held to be retroactive to the date of death of the testator. As the gift was void from the time of the death of the deceased, the disclaiming beneficiary never had an interest to transfer for the purposes of subsection 160(1) of the *ITA*. The principles of *Biderman* were cited with approval in the context of an *inter vivos* gift in *Leclair*, *supra* note 94.

<sup>109</sup> *Bank of Nova Scotia*, *supra* note 97 at para 6.

By contrast, a release or surrender involves the extinguishment or transfer of a legal right or claim to another person<sup>110</sup> and may be made for consideration or for no consideration.<sup>111</sup> If a beneficiary releases or surrenders a capital or income interest in a trust for consideration, or is deemed to have received consideration (for example, by directing the benefit to another person), this constitutes a disposition for tax purposes. The beneficiary is deemed to have received proceeds of disposition equal to the fair market value of the interest at the time of the release or surrender, as provided by paragraph 69(1)(b) of the *ITA*.<sup>112</sup> In the case of an income interest, the amount is included in the beneficiary's income under subsection 106(2) of the *ITA*. In the case of a capital interest, the beneficiary may realize a capital gain or loss, which is calculated as the difference between the proceeds of disposition and the greater of the adjusted cost base of the capital interest and the cost of the interest.

Where, however, an interest is validly released or surrendered in accordance with the terms of the trust and provincial law for no consideration, the disposing beneficiary will not be considered

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<sup>110</sup> The courts often use the term "disclaimer" to refer to disclaimers as well as to releases and surrenders. In *Re Skinner*, [1970] 3 O.R. 35 at para 5, 12 D.L.R. (3d) 227 ("*Re Skinner*"), Addy J. noted the following:

The law is clear that, where there is a single undivided gift, the donee must take the whole or disclaim the whole: he cannot disclaim part. This principle has been approved many times in the English Courts and, in my view, is also the law of our Province: *Guthrie v. Walrond* (1883), L.R. 22 Ch.D. 573 at p. 577: "...when two distinct legacies or gifts are made by a will to one person he is, as a general rule, entitled to take one and disclaim the other..." But where there is a *single undivided gift* "...such a gift is *prima facie* evidence that it was the testator's intention that the gift shall be one, and that the legatee shall either take it all or take none of it."<sup>110</sup>

In *Re Coulson*, [1977] 2 A.C.W.S. 182 at para 14, 16 O.R. (2d) 497 ("*Re Coulson*"), the Ontario Court of Appeal noted that Addy J. in *Re Skinner* had failed to consider the decision of Gillanders J.A. of the Court of Appeal, sitting as a High Court Judge in *Re Graydon*, [1942] O.W.N. 130, [1942] 2 D.L.R. 306 ("*Re Graydon*"). In this case, Gillanders J.A. noted the following at paras 7 and 8:

It is common ground that the widow might, before having accepted the benefit of any provision of the testator's will, by appropriate action have effectually disclaimed any such benefit. A person is not bound to accept against his wish provisions or benefits provided by a will. Counsel for the executor questions whether Mrs. Chipman, having lived in the house for a time and accepted the income from the proceeds thereof, and the income from the residuary estate to which she was entitled, for some years, can now effectually renounce and disclaim further benefits.

It seems clear that where a benefit is provided in a will which is coupled with a burden, obligation or condition that the beneficiary, while at liberty to disclaim before accepting any part of the benefit, cannot accept it, or some part of it, and then disclaim and thereby escape the burden, obligation or condition imposed, or to the prejudice of other parties.

The Ontario Court of Appeal in *Re Coulson* held that *Re Skinner* was wrongly decided and that the beneficiary in that case had validly disclaimed her interest in the income of the trust in question for a period of one year. While these cases refer to the principle of "disclaimer", they appear to be using this term to refer to transactions that could be characterized as disclaimers, releases and surrenders. In other words, these cases do not appear to draw a distinction among these terms. For tax purposes, however, the distinction is critical. Jurisprudence in respect of these matters should therefore be reviewed with care.

<sup>111</sup> CRA, Income Tax Folio S6-F2-C1, "Disposition of an Income Interest in a Trust" (25 November 2025) at para 1.13.

<sup>112</sup> *Ibid.*

to have received proceeds of disposition. This will only be the case, however, if the disposing beneficiary does not direct who is to receive the benefits or, if the disposing beneficiary does direct who will benefit, the persons to whom the benefit is directed are those that would be entitled to benefit without the releasing beneficiary's designation.<sup>113</sup>

In *Murphy Estate v. R.*,<sup>114</sup> adult children of the deceased agreed to release, convey and transfer their interests in the subject RRSP to the surviving spouse of the deceased in exchange for the release by the surviving spouse of her claims to real and personal property. The court held that the adult children had not disclaimed their interests in the subject RRSP; rather, they had assigned their interests.<sup>115</sup>

In so ruling, the court in *Murphy Estates* distinguished *Hillis v. R.*,<sup>116</sup> a case in which the deceased died intestate leaving behind a spouse and two adult children. The adult children disclaimed their interest in the estate of the deceased. The spouse therefore became entitled to the entire estate. As the second disclaimer was not made until roughly two years after the death of the deceased, a question arose as to whether subsection 70(6) of the *ITA* (which then required indefeasible vesting in the spouse within 15 months) was applicable. The Court noted that the effect of the disclaimers was retroactive. However, “[i]t is only when the disclaimers were executed and the court order was pronounced that Mrs. Hillis became entitled to the whole of her husband's estate with retroactive effect to the date of his death.”<sup>117</sup> As such, while the disclaimers took effect from the date of death of the deceased, the vesting of the estate in the spouse did not take place within the 15 month period then allowed under subsection 70(6) of the *ITA*.

In contrast to *Hillis*, the adult children in *Murphy Estate* accepted the gift of the proceeds of the RRSP and, subsequently, consented to transfer of their interests to the surviving spouse in exchange for the release by the surviving spouse of other claims. The Court held that this constituted an assignment as opposed to a disclaimer.

In summary, a valid disclaimer that is timely, not in favour of another and made before accepting any benefit is not a taxable event. By contrast, a release or surrender for consideration or in favour of another is a taxable disposition. Per S6-F2-C1, a release or surrender for no consideration and not in favour of another may not constitute a taxable disposition.<sup>118</sup> These rules are designed to ensure that only genuine relinquishments of trust interests, and not those made for value or to redirect benefits, are free from tax consequences. Careful attention to the timing, form and substance of the relinquishment is essential to avoid unintended tax results.

It is important to note that, if a beneficiary assigns their capital interest to another person, the assignee does not automatically become a beneficiary under the trust unless the trust terms allow

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<sup>113</sup> CRA, Income Tax Folio S6-F2-C1, “Disposition of an Income Interest in a Trust” (25 November 2025) at para 1.15. Note that the CRA is of the view that, “the attribution rules in subsections 74.1(1) and (2) will apply if the person or persons who benefit under the terms of the trust as a consequence of the release or surrender, are persons described in those subsections.” It is not certain that the CRA is correct in this assertion.

<sup>114</sup> *Murphy Estate v. R.*, 2015 TCC 8 (“*Murphy Estate*”).

<sup>115</sup> *Ibid* at para 31.

<sup>116</sup> *Hillis v. R.*, 83 D.T.C. 5365, [1983] C.T.C. 348 (“*Hillis*”).

<sup>117</sup> *Ibid* at para 31.

<sup>118</sup> The release or surrender may be viewed as a conferral of a benefit on the remaining beneficiaries. In appropriate cases, consider whether the attribution rules may apply.

for it. Any payment to the assignee may be considered a benefit conferred by the trust, and is potentially taxable under subsection 105(1) of the *ITA*. Furthermore, where a beneficiary directs the disposition of the beneficiary's interest to a non-arm's length party, the beneficiary may be deemed to have received proceeds of disposition equal to the fair market value of the interest under paragraph 69(a)(b) of the *ITA*. Again, this raises the question of what the fair market value of such an interest truly is.

**(b) The Addition of Beneficiaries to an Existing Trust**

**(i) Capital Disposition**

As noted, the requirement to regularly file Schedule 15s will allow the CRA to detect the addition and removal of beneficiaries far more easily than before. As such, decisions to add and remove beneficiaries should be made cautiously. The CRA's view on the addition of beneficiaries to a discretionary trust is that such an addition may result in a disposition by the existing beneficiaries of their capital interests in the trust, potentially resulting in capital gains for those existing beneficiaries. The CRA is of the view that the disposition by the existing beneficiaries will take place on a *pro rata* basis. In other words, where a trust with four existing beneficiaries adds a fifth beneficiary, each of the four existing beneficiaries may be held to have disposed of 5% of the total capital interest in the trust in favour of the new beneficiary.

The CRA has long taken the position that the addition of new beneficiaries to a trust may result in a partial disposition of the capital interests of the existing beneficiaries.<sup>119</sup> The CRA's position is explained in a 2008 Interpretation as follows:

A beneficiary's beneficial interest in a trust that is wholly discretionary is essentially a right of that beneficiary to be considered by the trustee as to whether or not any trust property (income or capital or a mixture thereof) should, in the trustee's discretion, be distributed or paid to or otherwise transferred or used for the benefit of that beneficiary...

When additional beneficiaries are added to a trust, whether as a result of a variation of the trust or pursuant to the terms of the trust, the rights of the existing beneficiaries as described in the previous paragraph are arguably diminished and as a result, each of the existing beneficiaries realizes a disposition of a part of the bundle of rights that forms his or her interest in the discretionary trust. Thus, it is our view that the Existing Beneficiaries did realize a disposition of part of their interest in the Trust when the New Beneficiaries were added to the Trust.<sup>120</sup>

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<sup>119</sup> See CRA Views, Ruling, "2001-0111303 – Beneficiary Added to Discretionary Trust" (2002); CRA, Views, Conference, "2010-0373401C6-T – Trusts and Addition of a Beneficiary" (8 October 2010); CRA, Views, Interpretation – External, "2012-0451791E5 – Disposition of Trust Interest" (11 February 2013); CRA, Views, Ruling, "2020-0862431R3-T – Variation of a trust deed and addition of new beneficiaries (Unofficial Translation)" (2021).

<sup>120</sup> CRA, Views, Interpretation – Internal, "2008-0281411I7 – Addition of Beneficiaries" (20 November 2008).

If the CRA is correct in its view, the existing beneficiaries may be deemed to have received proceeds of disposition in respect of the partial disposition of their interests in the trust where new beneficiaries are added. The CRA takes the position that, where the new beneficiary is a “person with whom the existing beneficiaries were not dealing at arm’s length”, paragraph 69(1)(b) of the *ITA* may apply so as to deem the existing beneficiaries to have received proceeds of disposition equal to the fair market value of the capital interest disposed of.<sup>121</sup>

Paragraph 69(1)(b) of the *ITA* reads as follows:

where a taxpayer has disposed of anything

(i) to a person with whom the taxpayer was not dealing at arm’s length for no proceeds or for proceeds less than the fair market value thereof at the time the taxpayer so disposed of it,

(ii) to any person by way of gift, or

(iii) to a trust because of a disposition of a property that does not result in a change in the beneficial ownership of the property;

the taxpayer shall be deemed to have received proceeds of disposition therefor equal to that fair market value...

The CRA has taken the position that subsection 69(1) of the *ITA* may apply where a trustee/beneficiary exercises a power to appoint more beneficiaries.<sup>122</sup> It has also taken the opposite position however, and noted that subsection 69(1)(b) would not apply “provided the existing beneficiaries do not direct to whom the interest is transferred... This is also true for the trustee/beneficiary who, in this situation, is not considered to have control over the decision to add a new beneficiary.”<sup>123</sup> Interestingly, it took the position that the addition of a corporate beneficiary would result in a disposition of capital interests of the existing beneficiaries, even if all of the shares of the corporate beneficiary were owned by one or more of the existing beneficiaries.<sup>124</sup>

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<sup>121</sup> See subsection 248(1) “disposition” and paragraph 69(1)(b) of the *ITA*. See also CRA, Views, Conference, “2010-0373401C6-T – Trusts and Addition of a Beneficiary (Unofficial Translation)” (8 October 2010), which confirms the CRA’s view that paragraph 69(1)(b) of the *ITA* would apply where a new corporate beneficiary, all of the shareholders of which are the existing beneficiaries of a trust, is added to a trust.

<sup>122</sup> CRA, Views, Interpretation – Internal, “2008-0281411I7 – Addition of beneficiaries” (20 November 2008).

<sup>123</sup> CRA, Views, Ruling, “2020-0862431R3-T – Variation of a trust deed and addition of new beneficiaries (Unofficial Translation)” (2021).

<sup>124</sup> CRA, Views, Conference, “2010-0373401C6-T – Trusts and Addition of a Beneficiary (Unofficial Translation)” (8 October 2010).

Though the commentary released by the CRA appears to treat the beneficiaries as a group for the purposes of determining whether they have, collectively, disposed of their capital interests in the trust in question when new beneficiaries are added, there does not appear to be any reason why paragraph 69(1)(b) of the *ITA* could not apply to some beneficiaries and not to others when new beneficiaries are added to an existing trust. For example, a new beneficiary may deal at arm's length with some existing beneficiaries and not with others. It may also be that a single beneficiary (likely, the beneficiary who is also a trustee) directs the addition of the new beneficiary without consulting with the other beneficiaries. This sets this issue apart from the "trap" arising when an amendment or variation of a trust deed is considered to alter the substratum of the trust. In that case, the resulting resettlement would affect the trust and, therefore, all of its beneficiaries.

The CRA does not appear to be reassessing trust beneficiaries pursuant to paragraph 69(1)(b) of the *ITA* on the addition of new beneficiaries with any frequency at present. However, with the influx of information resulting from the implementation of the enhanced trust reporting rules, the addition of beneficiaries to existing trusts will likely be easier for the CRA to track. Should the CRA use this information to begin issuing reassessments, we may soon have judicial guidance in respect of the application of paragraph 69(1)(b) in these circumstances. In the interim, it is prudent to be aware of this issue and to consider whether a given transaction will indeed invoke paragraph 69(1)(b) of the *ITA*, thereby possibly triggering tax for existing beneficiaries.

(ii) The Risk of an Assessment Under Section 160

Where a person (a "Transferor") transfers property (the "Property") to a transferee (the "Transferee") that is their spouse / common law partner, a non-arm's length party or a person under 18 years of age, the Transferee will be jointly and severally liable with the Transferor under subsection 160(1) of the *ITA* for an amount equal to the lesser of:

- The total of all amounts that the Transferor is liable to pay in respect of the taxation year in which the Property was transferred or any preceding taxation year; and
- The excess of the fair market value of the Property (at the time of transfer) over the fair market value (at that time) of the consideration given for the Property.<sup>125</sup>

Subsection 160(1) is a "draconian provision" in respect of which there is no due diligence defence. It may apply to transferees that have no knowledge of the tax debt of the transferor and that have no intention of assisting the transferor in avoiding the payment of tax.<sup>126</sup>

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<sup>125</sup> Paragraph 160(1)(d) can also apply to make the Transferee jointly and severally liable with the Transferor in respect of the Transferor's tax for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of certain provisions in respect of any income from, or gain from the disposition of, the Property or property substituted for it.

<sup>126</sup> *Wannan v. Canada*, 2003 FCA 423 at para 3 ("*Wannan*").

In *Goldman v. The Queen*,<sup>127</sup> Graham J. noted that, for the purposes of subsection 160(1), “there are three distinct types of transfers that occur when a trust is used.”<sup>128</sup> These types of transfers are as follows:

1. Transfer from the settlor on the settlement of the trust.

In this case, Graham J. notes that subsection 104(2) deems the trust to be an individual in respect of property settled on it. As such, it is the trust itself (as opposed to the trustee) that may be liable under subsection 160(1) of the *ITA* in respect of property settled on the trust. Where the settlor of a trust deals otherwise than at arm’s length with one or more of the beneficiaries of the trust, the settlor will be deemed not to deal with the trust at arm’s length.<sup>129</sup> As such, where the settlor is a tax debtor at the time of the transfer (or becomes one by the end of the year of transfer) and deals at non-arm’s length with one or more of the beneficiaries of the trust, the trust may be jointly and severally liable under subsection 160(1) in respect of the settlor’s tax liability.<sup>130</sup>

2. Transfer of additional contributions to the trust over time.

Where additional transfers are received by a trust from tax debtors after the trust is settled, the treatment will be similar to that outlined above in respect of the initial settlement. Furthermore, if dividends are received in respect of shares held by the trust in a non-arm’s length corporation that is a tax debtor (or becomes one by the end of the taxation year of the transfer), the trust may be assessed under subsection 160(1) in respect of these dividends.

3. Transfer to beneficiaries.

Graham J. notes that beneficiaries may become liable for transfers involving trusts in two ways.

Where the trust owes a tax debt (as a result of a subsection 160(1) assessment or otherwise), transfers by the trust to beneficiaries may result in assessments against the beneficiaries under subsection 160(1) as the trust and beneficiaries are deemed not to deal at arm’s length with each other pursuant to paragraph 251(1)(b) of the *ITA*.

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<sup>127</sup> *Goldman v. The Queen*, 2021 TCC 13 at para 50 (“*Goldman*”).

<sup>128</sup> *Ibid* at para 50.

<sup>129</sup> *ITA* at paragraph 251(1)(b). Note that Graham J. indicates at paragraph 50 that “If the settlor of a trust is related to one or more of the beneficiaries, paragraph 251(1)(b) deems the settlor to deal with the trust at non-arm’s length.” This is true when one considers the interaction between paragraphs 251(1)(a) and 251(1)(b). However, paragraph 251(1)(b) states that a trust and a person a taxpayer and a personal trust are deemed not to deal with each other at arm’s length if the taxpayer, or any person not dealing at arm’s length with the taxpayer, would be beneficially interested in the trust. As the test for dealing otherwise than at arm’s length is broader than the test for relatedness, the test above is modified in this paper to account for the broader of the two tests. In other words, a transfer from a settlor to a trust may be caught under subsection 160(1) where the settlor deals with a beneficiary of the trust otherwise than at arm’s length. Relatedness is, strictly speaking, not required.

<sup>130</sup> Where, however, assets have been distributed from the trust, Graham J. notes that the trustee may be assessed under subsection 159(3).

In addition, where the settlor is a tax debtor that does not deal at arm's length with a beneficiary of the trust, the Minister may be able to assess the beneficiary pursuant to subsection 160(1) in respect of distributions from the trust (to the extent of amounts transferred while the settlor was a tax debtor<sup>131</sup>) without first assessing the trust. To this end, Graham J. notes the following:

With respect, the transfer of property from a settlor to a trust is a direct transfer. It is not a transfer "by means of a trust". It is a transfer "to a trust." The phrase "by means of a trust" refers to a transfer from a settlor to a beneficiary. Such a transfer is not a direct transfer. It is an indirect transfer from the settlor to the beneficiary "by means of a trust." As set out in paragraph 49(c) above, if the settlor and the beneficiary do not deal at arm's length, the beneficiary may be liable under subsection 160 in respect of this indirect transfer.<sup>132</sup>

If the CRA is correct in their position that the addition of a beneficiary to an existing trust constitutes a disposition by the existing beneficiaries of a portion of their capital interest in the trust, it may be necessary to add to the list set out by Graham J. in *Goldman*. Specifically, if the addition of a beneficiary constitutes a transfer by an existing beneficiary of a portion of their capital interest in the trust, there is a risk that, if the existing beneficiary in question is a tax debtor (or becomes one in the year of disposition), where the new beneficiary and the existing beneficiary do not deal at arm's length with one another (or where the new beneficiary is under 18 years of age), subsection 160(1) may apply in respect of the transfer. The new beneficiary may therefore be jointly and severally liable together with the existing beneficiary for an amount equal to the lesser of the fair market value of the capital interest disposed of and the tax debt of the existing beneficiary in question. If the trust in question is a discretionary trust, the question arises (once again) as to what the fair market value of the capital interest disposed of truly is.

It is of note that paragraph 69(1)(b) of the *ITA* (which, again, may deem existing beneficiaries to have received proceeds of disposition equal to the fair market value of the capital interest disposed of) speaks of a *disposition* whereas subsection 160(1) of the *ITA* speaks of a *transfer*. However, Thorsen P. stated in *Fasken Estate v. Minister of National Revenue* that:

The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this result, whether direct or circuitous, may properly be called a transfer.<sup>133</sup> (Emphasis added).

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<sup>131</sup> The relevant time is at the time of the transfer or within the year.

<sup>132</sup> *Goldman*, *supra* note 127 at para 59.

<sup>133</sup> *Fasken Estate v. Minister of National Revenue*, [1948] Ex. C.R. 580 at para 12, [1949] 1 D.L.R. 810 ("*Fasken Estate*"). See also *Dunkelman v. Minister of National Revenue*, [1960] Ex. C.R. 73 at 380, 59 D.T.C. 1242 ("*Dunkelman*") and *Gitelman v. The Queen*, 2007 TCC 544 at para 11 ("*Gitelman*").

In *Montreuil v. R.*, Dussault J. held that:

In addition, the definitions noted above indicate that transferring property or a right is the equivalent of distributing it. Such distribution is always from a person who is the owner or proprietor to another who becomes the beneficiary, whether by an act between the parties or by operation of law. In this sense, transferring does not necessarily imply a positive act by the transferor and neither does it require that a specific action be performed when alive.<sup>134</sup> (Emphasis added)

It is therefore possible that subsection 160(1) of the *ITA* could apply on the addition of capital beneficiaries to a trust where an existing beneficiary of the trust is a tax debtor (or becomes one by the end of the year of transfer) provided that the new beneficiary is a person with whom the existing beneficiary was not dealing at arm's length, is a person under 18 years of age or is a spouse or common-law partner of the existing beneficiary. This risk is, of course, even greater where the tax debtor beneficiary is also the trustee in respect of the trust.

Could this liability extend to future distributions in respect of the trust? It is possible that the Minister will take this position (especially if the tax debtor beneficiary is also the trustee of the trust). In *Panneton c. Le Roi*, Lafleur J. extended the reach of s. 160(1) of the *ITA* to transfers made by corporations of which a tax debtor was the sole shareholder to his spouse.<sup>135</sup> One can imagine a situation where a tax debtor beneficiary/trustee seeks to add a non-arm's length party as a beneficiary of an existing trust for the purpose of making distributions to them of all (or a large portion of) the assets of the trust. In such a circumstance, the CRA may well seek to assess the new beneficiary in respect of distributions received.

On another note, where a tax debtor that is a beneficiary has validly disclaimed their interest in a trust, the gift is deemed to be void *ab initio*. To this end, the Federal Court of Appeal noted in *Biderman* that “where there is a valid disclaimer, there is, in my view, no transfer of property, direct or indirect, and paragraph 160(1)(c) cannot apply to the person who so disclaims.”<sup>136</sup>

### (iii) Loss Restriction Event

In Budget 2013, a proposal was made to extend the existing loss-streaming and related rules (the “Old AOC Rules”) to trusts. The *ITA* already contained rules restricting certain tax attributes where control of a corporation was acquired. These provisions were in place largely to prevent the trading of corporate tax attributes among arm's length parties including where, for example, a party purchases shares of a corporation with unused losses from an arm's length party and then proceeds to access those losses by way of an amalgamation with a profitable corporation or a transfer of income-producing assets to the acquired corporation. The Old AOC Rules were

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<sup>134</sup> *Montreuil v. R.*, [1996] 1 C.T.C. 2182 at para 33, [1994] T.C.J. No. 418 (“*Montreuil*”).

<sup>135</sup> *Panneton c. Le Roi*, 2024 CCI 24 (“*Panneton*”). See also *Kieboom v. Minister of National Revenue*, [1992] 3 F.C. 488 (FCA) (“*Kieboom*”) which dealt with subsection 74(1) of the *ITA* (which used language similar to subsection 160(1)). In *Kieboom*, the Court noted that the definition of “property” in subsection 248(1) encompasses both the shares and the rights attached thereto.

<sup>136</sup> *Biderman*, *supra* note 98 at para 46.

drafted in order to restrict losses and other tax attributes so that they would be less useful following a change of control by an arm's length purchaser.

*De jure* control of a corporation rests with shareholders having "majority voting control over the corporation, as manifested by the ability to elect the directors of the corporation."<sup>137</sup> This makes sense on a number of levels. The holders of a corporation's voting shares have the ability to elect the directors of the corporation, which gives them effective supervision of the corporation in question. The controlling shareholders will also typically be those that have an economic interest in the corporation. As such, where an arm's length party wishes to acquire an interest in a corporation for the purpose of utilizing its tax attributes, it will typically acquire both the voting and non-voting shares of the corporation in question.<sup>138</sup>

Trusts are different. Where a trust holds a majority of the voting shares of a corporation, it is the trustees who have legal ownership of the shares and the ability to exercise the voting rights associated with those shares. Accordingly, the trustees control the corporation.<sup>139</sup> The trustees may have an economic interest in corporations held by the trust (if they are also beneficiaries of the trust) or they may not. It may therefore be possible, through any number of methods, to replace one group of beneficiaries with another, thereby transferring the economic interest in the underlying corporations without triggering an acquisition of control under the Old AOC Rules. In other words, economic ownership of trusts (and their underlying assets) could change without triggering an acquisition of control under the Old AOC Rules as long as the trustees did not change. Creative practitioners were aware of this and took advantage of the flexibility of trusts to circumvent the Old AOC Rules.

Parliament responded by enacting the loss restriction event rules (the "LRE Rules"), primarily through the introduction of section 251.2 of the *ITA*. The LRE Rules expand the net previously cast by the Old AOC Rules to catch both acquisitions of control and transfers of economic interests in the trust context (among other things).

While a detailed review of the LRE Rules is beyond the scope of this paper, a broad overview is provided to enable readers to appreciate the potential consequences of adding a beneficiary in circumstances where an LRE may be considered to take place as the CRA may very easily be able to track such changes through comparisons of filed Schedule 15s over time, making this a dangerous trap for the unwary.

Subsection 251.2 of the *ITA* sets out the circumstances in which a taxpayer will be subject to a loss restriction event (an "LRE"). Paragraph 251.2(a) states that a corporation will be subject to an LRE where control of the corporation is acquired by a person or group of persons. As a change of trustees of a trust holding a majority of the voting shares of the corporation may

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<sup>137</sup> *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795 at para 50 ("Duha Printers").

<sup>138</sup> This is not always the case. To this end, Parliament introduced section 256.1 of the *ITA* to deem an acquisition of control of a corporation for the purposes of the attribute trading restrictions (as defined in section 256.1) where a person or group of persons acquire shares of the corporation carrying more than 75 per cent of the fair market value of all the corporation's shares without otherwise acquiring *de jure* control and it is reasonable to conclude that one of the main reasons that the person or group does not control the corporation is to avoid the application of one or more specified provisions (as defined in that section).

<sup>139</sup> *Minister of National Revenue v. Consolidated Holding Co.*, [1974] SCR 419, 72 D.T.C. 6007 ("*Consolidated Holding Co.*").

trigger an acquisition of control, this may trigger an LRE. Acquisitions of control of corporations controlled by trusts are further discussed later in this paper.

Paragraph 251.2(b) of the *ITA* provides that a trust is subject to a loss restriction event if, after March 20, 2013 and after the trust's creation, a person becomes a "majority-interest beneficiary" ("MIB") or a group of persons becomes a "majority-interest group of beneficiaries" ("MIGB") of the trust. Where a trust is subject to an LRE and, immediately before that time the trust (or a group of persons of which the trust is a member) controls a corporation, control of that corporation (and of each corporation controlled by it immediately before that time) is deemed to have been acquired.<sup>140</sup>

By triggering an LRE when a person becomes an MIB or a group of persons becomes a MIGB of a trust, Parliament successfully introduced a mechanism to restrict the trading of tax attributes of corporations controlled by trusts among arm's length parties through the acquisition of interests in trusts. However, as will be demonstrated, the LRE Rules are not without their shortcomings.

Subsection 251.2(1) provides that MIB has the same meaning as in subsection 251.1(3) read without reference to the expression, "if any". Subsection 251.1(3) defines MIB of a trust, at any time, as a person whose interest as a beneficiary, *if any*, at that time in the income of the trust has, together with the income interests of all persons with whom the person is affiliated, a fair market value that is greater than 50% of the fair market value of all the income interests of the trust. A person will also be an MIB if the test would be met if the word "income" were replaced with the word "capital". In other words, where a beneficiary has, together with persons with whom it is affiliated, 50% of the fair market value of all of the income interests or capital interests in the trust, that person will be an MIB of the trust.

The removal of "if any" in the definition of MIB was likely meant to signal Parliament's intention that, for the purposes of the LRE Rules (as opposed to the affiliation rules, which are set out in section 251.1), a person must hold an interest in the trust as beneficiary in order to be an MIB of the trust. A person is a beneficiary of a trust where the person is beneficially interested in the trust.<sup>141</sup> As the term "beneficially interested" as defined in subsection 248(25) is extremely broad, it is unclear if this change will keep many taxpayers in the a typically family trust scenario out of the definition of MIB, particularly where the trust is drafted to include a broad power of appointment and the trust is settled by a non-arm's length party.

MIGB also has the same meaning as in subsection 251.1(3) for the purpose of section 251.2 (without modifications). A MIGB of a trust at any time means a group of persons each of whom is a beneficiary under the trust at that time such that if one person held the interests as a beneficiary of all of the members of the group, that person would be a MIB of the trust and, if any member of the group were not a member, this test would not be met. In other words, an MIGB is a group of beneficiaries whose combined interests would make a single person holding them a MIB, where this test would not be met if any member were excluded.<sup>142</sup>

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<sup>140</sup> Paragraph 256(7)(h) of the *ITA*.

<sup>141</sup> Subsection 251.1(3) of the *ITA*.

<sup>142</sup> Section 251.2 of the *ITA*.

While section 252.1 imports the definitions of MIB and MIGB from subsection 251.1(3), there is no provision in section 252.1 importing subparagraph 251.1(4)(d)(i) for the purposes of determining whether a person is affiliated with a trust.<sup>143</sup> Subparagraph 251.1(4)(d)(i), for the purposes of section 251.1, states that in determining whether a person is affiliated with a trust, if the amount of income or capital of the trust that a person may receive as a beneficiary under the trust depends on the exercise by any person of, or the failure by any person to exercise, a discretionary power, that person is deemed to have fully exercised, or to have failed to exercise, the power, as the case may be. Thus, for the purposes of determining affiliation under section 251.1, a trustee will be deemed to have distributed all of the trust capital to each capital beneficiary and all of the trust income to each income beneficiary. As such, for the purposes of section 251.1, each beneficiary of a discretionary trust will be an MIB. This does not appear to be the case with respect to the LRE Rules. As such, an LRE will (fortunately) not be triggered each time a new beneficiary is added. However, the purpose behind subparagraph 251.1(4)(d)(i) was likely to make the determination as to whether a particular person is an MIB simpler. There is no such assistance offered in respect of the LRE Rules.

As previously noted, it can be extremely difficult to determine the fair market value of an interest in a discretionary trust (though, in the view of some, it is quite simple insofar as the value of every interest is nil). If the value is not nil, it may be that the interests held by trustee-beneficiaries will be worth more than those of mere beneficiaries. In addition, the contingent nature of some interests may affect their value. It may be necessary to consider the history of distributions and the relationships among the various parties to determine the value of their respective interests. As such, determining whether a person is an MIB in respect of a discretionary trust for the purposes of the LRE Rules may be an extremely difficult exercise. Furthermore, it is arguable that a change in, for example, the pattern of distributions from the trust will affect the respective fair market values of the interests held by the beneficiaries, potentially triggering an LRE.

Subparagraph 251.2(5)(a)(ii) states that, in determining whether an individual (other than a trust) is affiliated with another individual (other than a trust) for the purposes of the LRE Rules, individuals connected by blood relationship, marriage or common-law partnership or adoption are deemed to be affiliated with one another. This is far broader than the rule for determining affiliation among individuals in section 251.1 of the *ITA*.

Subsection 251.2(4) of the *ITA* sets out circumstances in which a notional person will be deemed to become a MIB of a trust, thereby triggering an LRE. These provisions apply in two situations. The first, broadly, is where an MIB or member of an MIGB becomes a subsidiary (the “Acquisition”) of another person (the “Acquirer”) unless immediately before the Acquisition, the Acquirer was affiliated with the particular trust, or paragraph 251.2(4)(a) previously deemed a person to become an MIB because the person became a subsidiary of the another person that is a subsidiary of the Acquirer at the time of the Acquisition as a part of a series of transactions or events including the Acquisition.

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<sup>143</sup> Some commentators take the view that subparagraph 251.1(4)(d)(i) may be applicable for the purposes of section 252.1. However, this does not appear to be the better view.

The second situation where a notional person will be deemed to become an MIB of a trust, triggering an LRE is where, as part of a series of transactions or events, two or more persons acquire equity of the trust in exchange for or upon redemption or surrender of equity of, or as a consequence of a distribution from, a corporation, partnership or other trust. This provision will not apply to trigger an LRE, however, where any of three conditions apply. The first condition is met if a person affiliated with the corporation, partnership or trust was, immediately before the particular time, an MIB of the particular trust. The second condition is met if all the equity of the particular trust that was acquired at or before the particular time as part of the series were acquired by one person, the person would not at the particular time be an MIB of the particular trust. The third condition is met if paragraph 251.2(4)(b) previously applied to deem a person to become an MIB of the particular trust because of an acquisition of equity of the particular trust that was part of the series of transactions or events.

Subsection 251.2(3) of the *ITA* sets out several circumstances where a person will be deemed not to become an MIB (and a group of persons will be deemed not to become an MIB). These rules (referred to as the “continuity of ownership rules”) are intended to ensure that an LRE is not triggered by many of the typical transactions or events involving changes to the beneficiaries of a personal trust.<sup>144</sup> Notably, a person is deemed not to become an MIB, and a group is deemed not to become an MIB, solely because of:

1. The acquisition of an income or capital interest<sup>145</sup> of the trust by a person from a person with whom they were affiliated immediately before the acquisition. For example, if A acquires an income or capital interest from his parents, B and C, this would not trigger an LRE even where the fair market value of the combined interests of A, B and C in the capital of the trust exceeds 50% of the fair market value of all capital interests in the trust in question.<sup>146</sup> For the purposes of this exclusion, note the expanded list of affiliated individuals as set out in subparagraph 251.2(5)(a)(ii) for the purposes of section 251.2 which includes individuals connected by blood relationship, marriage or common-law partnership or adoption.

Note, also, that income and capital interests in family trusts are not typically acquired from other beneficiaries. However, if the CRA is correct in its position that the addition of new beneficiaries to a trust may result in a partial disposition of the capital interests of existing beneficiaries, this exclusion may assist in ensuring that the addition of new beneficiaries does not result in an LRE, where the new beneficiary is affiliated with the disposing beneficiaries immediately before being added as a beneficiary of the trust.

2. The acquisition of an income or capital interest of the trust by a person who was affiliated with the trust immediately before the acquisition. Persons can become affiliated with a trust in a variety of ways. If the trust controls a corporation, the trust and corporation will

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<sup>144</sup> *Supplementary Information to Budget 2013*.

<sup>145</sup> The term used in subsection 251.2(3) is “equity”. Subsection 251.2(1) states that, for the purposes of section 251.2, “equity” has the same meaning as in subsection 122.1(1) read without reference to paragraph (e) of the definition equity in that subsection. Paragraph (b) of the definition of “equity” in subsection 122.1(1) states that, if the entity is a trust, “equity” means an income or capital interest in the trust.

<sup>146</sup> Note, however, that due to the broad deeming rule for “beneficially interested” in subsection 248(25) of the *ITA*, A may already have been considered an MIB of the trust prior to the acquisition (depending on the circumstances).

be affiliated.<sup>147</sup> A trust is affiliated with its MIBs.<sup>148</sup> A person is also affiliated with a trust if the person would be affiliated with an MIB of the trust without reference to paragraph 251.1(1)(g) of the *ITA*. For example, where trusts A and B have a common MIB (Mr. X), trust A will not qualify as a person that would be affiliated with an MIB of trust B without reference to paragraph 251.1(1)(g) as the reason that trust A is affiliated with Mr. X is that Mr. X is an MIB of trust A. Affiliation would therefore not be established under paragraph 251.1(1)(g).

That said, two trusts may be affiliated where a contributor to one of the trusts is affiliated with a contributor of the other trust and an MIB of one of the trusts is affiliated with an MIB of the other trust, an MIB of one of the trusts is affiliated with each member of an MIB of the other trust, or each member of an MIB of each of the trusts is affiliated with at least one member of an MIB of the other trust.<sup>149</sup>

3. The acquisition of an income or capital interest of the trust by an estate from an individual, if the estate arose on and as a consequence of the individual's death and the estate acquired the income or capital interest from the individual as a consequence of the individual's death.
4. The acquisition of an income or capital interest of the trust by a person from an estate that arose on and as a consequence of the death of an individual, if the estate acquired the equity from the individual as a consequence of their death and the individual was affiliated with the person immediately before their death.
5. Variations in the terms of the trust, satisfaction or failure to satisfy a condition under the terms of the trust, the exercise or non-exercise of a power, or the redemption, surrender or termination of equity of the trust at any time, if each MIB and each member of a MIB of the trust immediately after that time was affiliated with the trust immediately before that time. Note, however, that where the redemption, surrender or termination of equity of the particular trust was held, immediately before that time, by an estate (as per subparagraph 251.2(3)(a)(iii)), the relevant time for testing affiliation is immediately before the individual's death.
6. The transfer all of the income and capital interests of the trust to a corporation, partnership or another trust (the "acquirer") where:
  - the only consideration for the transfer is equity of the acquirer, the acquirer held no property or property with only nominal value at all times before the transfer, and, immediately after the acquisition, the acquirer is not a subsidiary of any person nor a corporation controlled, directly or indirectly in any manner whatever, by a person or group of persons; or
  - a person was an MIB or a group of persons was a MIB of the particular trust immediately before that time, that MIB or MIB and no other person or group of

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<sup>147</sup> Subparagraph 251.1(1)(b)(i) of the *ITA*.

<sup>148</sup> Subparagraph 251.1(1)(g)(i) of the *ITA*.

<sup>149</sup> Paragraph 251.1(1)(h) of the *ITA*.

persons is, immediately after that time, in control of the acquirer (if it is a corporation), a majority-interest partner or majority-interest group of partners of the acquirer (if it is a partnership) or an MIB or MIGB of the acquirer (if it is a trust) and, at no time during a series of transactions or events that includes the transfer does the MIB or MIGB of the trust cease to be one of the persons or groups described above in respect of the acquirer.

7. A transaction the parties are obligated to complete under the terms of an agreement entered into before March 21, 2013.
8. The acquisition or disposition of equity in an "investment fund" trust, provided the transaction is not part of a series that results in the trust ceasing to be an investment fund.

These exceptions are designed to prevent LREs in situations where there is no substantive change in the economic ownership or where the changes are within a family or affiliated group, or in the context of certain investment vehicles.

Section 251.2 contains anti-avoidance provisions to prevent taxpayers from structuring transactions to avoid triggering an LRE or to inappropriately preserve or access losses.<sup>150</sup> For example, if it can reasonably be concluded that a transaction was undertaken to satisfy the affiliation conditions in the exceptions, those conditions are deemed not to be satisfied.

Given the significance of the LRE and the complexity of the LRE Rules, trustees should carefully consider the implications of adding beneficiaries. It would be prudent for trustees to carefully review the specific terms of the trust deed and the relationships among the parties alongside the LRE Rules to determine whether the addition of a beneficiary to the trust in question will trigger an LRE and what the consequences will be.

### ***(c) Amendment / Variation of Trust Deeds***

Where the trustee determines that, for any of the reasons discussed in this paper (or, indeed, for reasons not discussed in this paper), it would be advantageous to have a beneficiary removed or the trust deed otherwise amended, can this be done? If so, will an amendment or variation trigger tax for the trust or its beneficiaries?

A trust deed can be amended<sup>151</sup> if permitted by its terms or by court order.<sup>152</sup> The tax consequences for an amendment or variation will be dependent on the nature and extent of the

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<sup>150</sup> See, for example, subparagraph 251.1(5)(a)(iii) of the *ITA*, paragraph 251.1(5)(b) of the *ITA* and paragraph 251.1(5)(c) of the *ITA*.

<sup>151</sup> Note: a trust can also be terminated where all of the potential and ascertained objects of a trustee's discretion universally agree that the trust property is to be conveyed to them. This is referred to as the rule in *Saunders v. Vautier*.

<sup>152</sup> The *Trust and Settlement Variation Act*, [RSBC 1996] Chapter 463 provides that the Supreme Court may, on behalf of certain persons (including beneficiaries that are incapable of assenting, persons that may become entitled to interests at a future date or on the happening of a future event, and unborn persons), approve any arrangement proposed by any person, varying or revoking all or any of the trusts or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts.

amendments. Amendments that are administrative in nature<sup>153</sup> or contemplated by the original trust deed often will not result in a resettlement or a deemed disposition.<sup>154</sup> Fundamental changes to the trust's purpose,<sup>155</sup> class of beneficiaries, or distribution terms may result in a resettlement, with significant tax consequences. Each situation must be analyzed on its specific facts, the language of the trust deed, and the nature of the proposed amendment. Professional advice should be sought before proceeding with any amendment to a trust deed.

For a more detailed discussion on this topic, please see Joel Nitikman's article, *Life is Change: Using Powers of Amendment in a Non-Charitable Trust--Rules and Tax Implications*.<sup>156</sup>

#### **4. Appointment / Replacement of Trustees – Acquisition of Control Issues**

As previously noted, paragraph 251.2(2)(a) of the *ITA* states that a corporation will be subject to an LRE where control of the corporation is acquired by a person or group of persons. This portion of the paper will discuss the LRE that may be triggered in respect of a corporation where there is a change to the composition of the trustees of a trust holding a majority of the voting shares of the corporation. LREs arising where a person becomes an MIB of a trust or where a group of persons becomes an MIGB of a trust was covered elsewhere in this paper.

Where a trust holds voting shares of a corporation, trustees have legal ownership of the shares and the ability to exercise the voting rights associated with those shares. Accordingly, where a trust holds a majority of the voting shares of a corporation, the trustees of the trust control the corporation.<sup>157</sup> Where shares are held by a trust, it is necessary to examine the trust instrument to determine any limitations on the trustees' powers to vote the shares. If the trust instrument imposes such limitations, these must be taken into account in determining *de jure* control of any underlying corporations.<sup>158</sup> Where, for example, the trust instrument in question allows a subset of trustees to direct the voting, that subset may be considered the controlling group.

Subsection 256(7) of the *ITA* contains specific rules relating to acquisitions of control. Paragraph 256(7)(a)(i)(A) of the *ITA* provides that control is not acquired solely because shares are acquired by a person from a related person. Clause 256(7)(a)(i)(B) provides that control is not acquired solely because of the acquisition of shares by a person who was related to the corporation immediately before that time. A discussion regarding the concept of relatedness is available elsewhere in this paper.

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<sup>153</sup> See CRA, Views, Ruling, "2018-0779201R3 – Variation of Trust Deed" (2018) and CRA, Views, Ruling, "2019-079576 – Variation of a Trust" (2019).

<sup>154</sup> See CRA, Views, External Technical Interpretation, "2012-0451791E5 – Disposition of Trust Interest" (11 February 2013).

<sup>155</sup> See CRA, Views, Internal Technical Interpretation, "2014-0526171I7 – Resettlement of a Trust" (9 August 2016), where the sale by the holder of a majority beneficial interest in a commercial trust changed the whole substratum of the trust. In this instance, the trust deed did not specifically prohibit the disposition by the two original beneficiaries of their interests in the trust. However, the trust deed clearly noted the settlors' intention to have the trustee hold and invest the capital of the trust for the benefit of the two original beneficiaries.

<sup>156</sup> Joel Nitikman, "Life Is Change: Using Powers of Amendment in a Non-Charitable Trust—Rules and Tax Implications" (2017) 65:3 *Canadian Tax Journal* 559-632.

<sup>157</sup> *Consolidated Holding Co.*, *supra* note 139.

<sup>158</sup> *Duha Printers*, *supra* note 137 at para 49.

Furthermore, control will not be deemed to have been acquired solely because shares are acquired by an estate that acquired the shares because of the death of a person (clause 256(7)(a)(i)(C)) or where the shares are acquired by a person that acquired the shares from an estate arising on and as a consequence of the death of an individual, if the estate acquired the shares from the individual as a consequence of the death and the individual was related to the person immediately before the death (clause 256(7)(a)(i)(D)).

The position of the CRA in respect of acquisitions of control of corporations in the trust context, as reflected in multiple technical interpretations and roundtable responses, is as follows:

- Where a trust holds a majority of the voting shares of a corporation, the trustees as a group are presumed to control the corporation, unless the trust instrument provides otherwise. If the trust instrument requires unanimous or majority decisions, the controlling group is defined accordingly.<sup>159</sup>
- A change in the composition of that group (such as replacement of a trustee) is generally considered a change in the controlling group, triggering an acquisition of control, unless an exception applies.<sup>160</sup>
- If the new trustee is related to the outgoing trustee and the replacement is concurrent, paragraph 256(7)(a) of the *ITA* may apply to prevent an acquisition of control.<sup>161</sup>
- Where an executor, administrator or trustee is replaced as a result of their passing or inability to fulfill their functions, control of the underlying corporation will be regarded as remaining unchanged.<sup>162</sup>

Paragraph 256(7)(i) of the *ITA*, contains a relieving provision for trusts. This provision states that if, after September 12, 2013, a trust controls a corporation, a change in trustee or legal representative does not constitute an acquisition of control if:

1. The change is not part of a series of transactions or events that includes a change in the beneficial ownership of the trust's property; and

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<sup>159</sup> See CRA, Views, Conference, “2022-0928191C6 – STEP 2022—Q 6—Acquisition of control” (15 June 2022); CRA, Views, Conference, “2011-0401931C6 – Acquisition of control—2011 STEP Conference Q17” (3 June 2011); CRA, Views, Interpretation—External, “2004-0087761E5 – Acquisition of control – replacement of trustees” (24 May 2005); CRA, Views, “Income Tax – Technical News No. 34” (27 April 2006) (Archived); and CRA, Views, Conference, “2007-0240431C6—2007 STEP Conference—Question 12—Change in trustees and control” (8 June 2007).

<sup>160</sup> CRA, Views, Conference, “2022-0928191C6 – STEP 2022—Q 6—Acquisition of control” (15 June 2022) and CRA and Views, Conference, “2011-0401931C6 – Acquisition of control—2011 STEP Conference Q17” (3 June 2011).

<sup>161</sup> CRA, Views, Conference, “2022-0928191C6 – STEP 2022—Q 6—Acquisition of control” (15 June 2022).

<sup>162</sup> CRA, Views, Conference, “2024-1003461C6 – STEP CRA Roundtable 2024 – Q4: Acquisition of Control” (4 June 2024) and CRA, Views, Conference, “2011-0401931C6 – Acquisition of Control – 2011 STEP Conference Q17 (3 June 2011). Note: these are administrative positions that may be withdrawn in the future. For further details, see CRA, Views, Conference, “2007-0240431C6—2007 STEP Conference—Question 12—Change in trustees and control” (8 June 2007).

2. No amount of income or capital of the trust to be distributed, at any time at or after the change, in respect of any interest in the trust depends upon any person's exercise of (or failure to exercise) any discretionary power.

This exclusion, while very useful, is not easy for a trust to access where the trustee is in a position to exercise discretion of any kind. For example, in a 2019 APFF conference roundtable session, the CRA took the position that, where trustees of a spousal trust change, discretionary power exists (and, therefore, paragraph 256(7)(i) is not available) where the trustees are empowered to encroach on trust capital for the benefit of the spouse beneficiary. In clarifying its position, the CRA noted the following:

Subparagraph 256(7)(i)(ii) is broadly worded and provides that at any time at or after the replacement of the trustee, no amount of income or capital to be distributed in respect of an interest in the trust depends upon the exercise, or the failure to exercise, by any person or partnership of a discretionary power. Consequently, depending on the circumstances and terms of the Trust Indenture, the condition set out in subparagraph 256(7)(i)(ii) could not be satisfied in the case of a spousal trust as defined in paragraph 70(6)(b), which would result in paragraph 256(7)(i) not applying to deem there to be no acquisition of control of the corporation. This could be the case *inter alia* where the trustees of a spousal trust have a power to encroach on the capital in favour of the spouse or common-law partner.<sup>163</sup>

Given the significant tax consequences arising on changes of control, care should be taken when making decisions regarding the addition or replacement of trustees. To the extent practicable, tax consequences of the appointment of trustees should be considered alongside non-tax considerations to ensure the proper functioning of trusts without the inadvertent triggering of adverse tax consequences.

## **5. The Aggregation Rules**

The aggregation rules seek to track the sharing of economic interests within structures and impact the application of a number of provisions of the *ITA*.

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<sup>163</sup> CRA, Views, Conference, “2019-0812781C6 F - Acquisition of control and trusts” (11 October 2019).

The aggregation rules are complex and nuanced – especially where trusts are involved. While working knowledge of these rules is extremely important for avoiding the unwanted (and attracting the wanted) consequences of associated, affiliated, related and non-arm’s length status, a number of practitioners remain unaware of the rules and how they apply. It is, unfortunately, quite easy for practitioners to create relationships or links among participants involved (actively or passively) in a structure involving a trust without realizing it. With the introduction of the enhanced trust reporting rules, the CRA will be provided with more information about trust participants. It will therefore be easier than ever for the Minister to “connect the dots” to determine how individuals and entities interact with one another (and to deem them to be linked to one another, resulting in negative tax consequences). It is therefore prudent for practitioners to review these rules when drafting trusts and wills and in crafting reorganizations involving the use of trusts.<sup>164</sup>

While a detailed review of the aggregation rules is beyond the scope of this paper, a broad overview is provided to enable readers to appreciate the potential tax consequences of aggregation.

**(a) Relatedness and Non-Arm’s Length: Section 251**

Section 251 of the *ITA* sets out the rules for determining when persons are related and when they are not dealing at arm’s length. The concept of relatedness is relevant for the application of, among other things, the surplus stripping rules, the benefit conferral provisions, qualification as qualified small business corporation shares, the debt forgiveness and debt parking rules and the restrictive covenant provisions. The concept of arm’s length is relevant for a large number of provisions of the *ITA* including the acquisition of control rules, the thin capitalization rules, the divisive reorganization rules, deeming rules on disposition of assets at below (or in excess of) fair market value and joint and several liability on the transfer of property.

Subsection 104(1) of the *ITA* provides that, unless the context otherwise requires, a reference to a trust includes a reference to the trustee, executor, administrator, liquidator of a succession, heir, or other legal representative having ownership or control of the trust property. Subsection 104(2) of the *ITA* further deems a trust to be, in respect of the trust property, an individual. This deeming is significant for the application of the relatedness rules in section 251 of the *ITA*, as it allows the trust to be treated as an individual for the purposes of determining whether it is related to a beneficiary or other person.<sup>165</sup>

Subsection 251(1) of the *ITA* sets out some general principles in determining whether persons deal with each other at arm’s length. These are as follows:

1. Related persons are deemed not to deal with each other at arm’s length.<sup>166</sup>

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<sup>164</sup> A comprehensive review of the aggregation rules is beyond the scope of this paper. For a detailed analysis of the application of the aggregation rules in the trust context, please see Jeffrey Love and Kenneth Hauser, "How Various Aggregation Rules Apply to Trusts," in *Report of Proceedings of the Seventieth Tax Conference*, 2018 Conference Report (Toronto: Canadian Tax Foundation, 2019), 28:1-79.

<sup>165</sup> CRA, Views, Interpretation—Internal, “2009-031189117 – Trust related to a beneficiary” (30 June 2009).

<sup>166</sup> Paragraph 251(1)(a) of the *ITA*.

Related persons are deemed by paragraph 251(1)(a) not deal with each other at arm's length. Subsection 251(2) of the *ITA* defines "related persons" to include individuals connected by blood, marriage, common-law partnership or adoption, as well as certain relationships involving corporations and groups of persons. More specifically, the following persons are related for the purposes of the *ITA*:

- individuals connected by blood relationship, marriage or common-law partnership or adoption;
- a corporation and
  - a person who controls the corporation (if it is controlled by one person) or a person related to this person;
  - a person who is a member of a related group that controls the corporation, or a person related to such a person;
- two corporations if they are controlled by the same person or group of persons or if they meet any of the other criteria set out in paragraph 251(2)(c).

As a person who controls a corporation is deemed to be related to it, a trust that owns a majority of the voting shares of a corporation will be deemed to be related to the corporation.<sup>167</sup>

Furthermore, as previously noted, where a trust holds voting shares of a corporation, trustees have legal ownership of the shares and the ability to exercise the voting rights associated with those shares. A reference to a trust is to be read to include a reference to the trustee with ownership and control of the property.<sup>168</sup> Accordingly, where a trust holds a majority of the voting shares of a corporation, the trustees of the trust will control the corporation<sup>169</sup> and will be deemed to be related to it.<sup>170</sup>

Persons related to the person or group that controls the corporation will also be related to it.<sup>171</sup> As such, those related to a trustee as a result of a blood relationship, marriage / common-law partnership or adoption would also be related to a trust.<sup>172</sup> While beneficiaries are deemed to be dealing at non-arm's length with a personal trust pursuant to paragraph 251(1)(b) (as further discussed below), beneficiaries may also be related to a trust if they are related to the trustee of the trust.<sup>173</sup>

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<sup>167</sup> Subparagraph 251(2)(b)(i) of the *ITA*.

<sup>168</sup> Subsection 104(1) of the *ITA*.

<sup>169</sup> *Consolidated Holding Co.*, *supra* note 139.

<sup>170</sup> Paragraph 251(1)(b)(i) of the *ITA*. It will, however, be necessary to examine the trust instrument to determine any limitations on the trustees' powers to vote the shares and to take these into account in assessing control of any underlying corporations. See *Duha Printers*, *supra* note 137.

<sup>171</sup> Subparagraph 251(2)(b)(iii) of the *ITA*.

<sup>172</sup> See CRA, Views, Interpretation – Internal, “2009-0311891I7 – Trust related to a beneficiary” (30 June 2009).

Where there are multiple trustees, it may be necessary for the beneficiaries (or other parties related to the trustees) to be related to all of the trustees in order to be considered to be related to the trust: CRA, Views, Interpretation – Internal, “2009-0311891I7 – Trust related to a beneficiary” (30 June 2009).

<sup>173</sup> See CRA, Views, Technical Interpretation – Internal, “2001-0096247 – Scientific research and experimental development—investment tax credit” (24 August 2001). The CRA has stated that “[a]lthough ... beneficiaries and the trust are deemed not to be dealing at arm's length under paragraph 251(1)(b), the beneficiaries and the trust are

As noted, related persons are deemed not to deal with each other at arm's length. However, the reverse is not true.

2. A taxpayer and a personal trust (other than a trust excluded by paragraph 251.(1)(b))<sup>174</sup> are deemed not to deal at arm's length if the taxpayer (or any person that does not deal at arm's length with the taxpayer) would be beneficially interested in the trust if subsection 248(25) were read without reference to subclauses 248(25)(b)(iii)(A)(II) to (IV).<sup>175</sup>

A "personal trust" is a trust (other than a unit trust) that is a graduated rate estate or a trust in which no beneficial interest was acquired for consideration payable (directly or indirectly) to the trust or a person or partnership that has made a contribution to the trust.<sup>176</sup> An interest in a trust will be deemed not to be acquired for consideration solely because it was acquired in satisfaction of any rights as a beneficiary under the trust to enforce payment of an amount by the trust.<sup>177</sup> Furthermore, for the purposes of the definition of "personal trust", where all of the beneficial interests in a trust acquired by way of the transfer, assignment or other disposition of property to the particular trust were acquired by one person or two or more related persons, any beneficial interest in the trust acquired will be deemed to have been acquired for no consideration.<sup>178</sup>

The term "beneficially interested" is defined in paragraph 248(25)(a) to include "any person or partnership that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under a trust to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more trusts or partnerships". Paragraph 248(25)(b) (as modified by paragraph 251(1)(b) extends the definition to non-beneficiaries that may, on the exercise of discretion by a person or partnership, become a beneficiary at a later date where the trust has acquired property (directly or indirectly) in any manner whatever from the non-beneficiary. Finally, paragraph 248(25)(c) notes that a member of a partnership that is beneficially interested in a trust is deemed to be beneficially interested in the trust.

In the CRA's view, the circumstance in which an individual may be beneficially interested in a trust include where trust income is payable to the individual, income is held in trust and will be paid when the individual attains a certain age (even where the individual's right to receive income will cease if the beneficiary dies before attaining the specified age), the individual is one

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not described as "related persons" under that definition in subsection 251(2) or under paragraph 251(1)(b). Accordingly, paragraph 251(1)(a) would not apply to deem the beneficiaries and the corporation to be dealing at non-arm's length."

<sup>174</sup> For the purposes of determining arm's length dealings under section 251.1, certain trusts described in the definition of "trust" under subsection 108(1) (including amateur athlete trusts, employee trusts, pooled registered pension plans, registered disability savings plans, registered retirement savings plans, related segregated funds trusts, RCA trusts and cemetery care trusts) are excluded from the definition of "personal trust".

<sup>175</sup> Paragraph 251(1)(b) of the *ITA*. The exclusion of subclauses 248(25)(b)(iii)(A)(II) to (IV) has the effect of ensuring that fewer non-beneficiaries will be deemed to act at non-arm's length with personal trusts (except where, for example, the trust has acquired property, directly or indirectly in any manner whatever from the non-beneficiary in question and the non-beneficiary may be added as a beneficiary at a later date).

<sup>176</sup> Paragraph 248(1) of the *ITA*.

<sup>177</sup> Paragraph 108(7)(a) of the *ITA*.

<sup>178</sup> Paragraph 108(7)(b) of the *ITA*.

for whom a preferred beneficiary election may be made, the individual is one of a class who has a remainder interest in the trust or the individual has contributed property to the trust and may be added as a beneficiary at a later date by virtue of a power or appointment.<sup>179</sup>

It is of note that a person that does not deal at arm's length with a person that does not deal at arm's length with the trust will, themselves be deemed not to deal at arm's length with the trust under paragraph 251(1)(b). For example, two personal trusts may not deal at arm's length with one another if they have a common beneficiary. In this case, a person (the common beneficiary) dealing not at arm's length with the taxpayer (that is, trust A) would be beneficially interested in the trust (that is, trust B). As such, the trusts would be deemed to deal at non-arm's length under paragraph 251(1)(b).

3. In any other case, it will be a question of fact whether unrelated persons deal with each other at arm's length at a particular time.<sup>180</sup>

The CRA takes the view that there is a general presumption that a trust does not deal at arm's length with its settlor.<sup>181</sup> This presumption will not, however always apply. For example, where the trustee is a professional trustee and the settlor has not maintained a degree of influence over the trustee or where the settlor transfers all of the usual rights of ownership of the settled property and the trustee is free of the settlor's influence, the settlor may be considered to deal with the trust at arm's length. The transfer of property from a deceased to the estate or to a testamentary trust created in the will of the deceased, will also be considered by the CRA to take place at arm's length.<sup>182</sup>

There are many other circumstances in which unrelated parties deal with one another otherwise than at arm's length. In making this determination, courts have looked to the existence of a common mind directing the bargaining for both parties to a transaction, whether the parties act in concert without separate interests, and for indications of *de facto* control. A detailed discussion of these matters is beyond the scope of this paper, especially as factual non-arm's length relationships will not always be ascertainable by virtue of the enhanced trust reporting rules.

Subsection 251(5) of the *ITA* contains important aggregation and look-through rules for determining control of corporations, including where rights to acquire shares or control voting rights exist, and for treating a person as related to themselves in different capacities as shareholders of different corporations. These rules are often relevant in trust structures where a trustee or beneficiary may have rights or interests in multiple entities but are beyond the scope of this paper.

### **(b) Affiliation**

Section 251.1 of the *ITA* introduces the concept of "affiliated persons," which is broader and more mechanical than the relatedness rules. The affiliated person rules are central to the

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<sup>179</sup> CRA, Income Tax Folio S1-F5-C1 "Related Persons and Dealing at Arm's Length" (26 November 2015) at 1.31 and 1.32.

<sup>180</sup> Paragraph 251(1)(c) of the *ITA*.

<sup>181</sup> CRA, Income Tax Folio S1-F5-C1 "Related Persons and Dealing at Arm's Length" (26 November 2015) at 1.51.

<sup>182</sup> *Ibid.*

application of a variety of stop-loss rules, including the superficial loss rules. These rules are meant to prevent taxpayers from using affiliated parties to create artificial tax losses and ensure that losses are only recognized when there is a genuine change in ownership of the property in question.

Subsection 251.1(1) of the *ITA* sets out a detailed list of relationships that constitute affiliation, including between individuals and their spouses or common-law partners, corporations and those that control them and between corporations controlled by affiliated persons or groups.<sup>183</sup> The section also addresses affiliation between trusts, beneficiaries, contributors and partnerships. It is of note that all affiliated persons are related, but the reverse is not true. For the purposes of the *ITA*, the following persons (among others) are affiliated under subsection 251.1(1) of the *ITA*:

- an individual and a spouse or common-law partner of the individual: s.251.1(1)(a). Note that section 251.1 does not contain a provision similar to section 251.2 extending the list of individuals that are deemed to be affiliated with one another to include individuals connected by blood relationship, marriage or common-law partnership or adoption, except in determining whether a contributor to one trust is affiliated with a contributor of another trust<sup>184</sup>.
- a corporation and a person that controls<sup>185</sup> the corporation: s. 251.1(1)(b)(i) or their spouse or common-law partner: s. 251.1(1)(b)(iii) Note, a trust that holds a majority of the voting rights of a corporation will be deemed to be affiliated with the corporation. However, as subparagraph 251.1(4)(c) states that, notwithstanding subsection 104(1), a reference to a trust does not include a reference to the trustee for the purposes of section 251.1. As such, a trustee will not be deemed affiliated with a corporation controlled by the trust.
- a corporation and each member of an affiliated group of persons that controls the corporation: s. 251.1(1)(b)(ii) or their spouses or common-law partners: s. 251.1(1)(b)(iii).
- two corporations if the person that controls one corporation is affiliated with the person that controls the other, if the person that controls one corporation is affiliated with each member of the group of persons that controls the other or if each member of the group of persons that controls each corporation is affiliated with at least one member of the group of persons that controls the other: s. 251.1(1)(c)(i) - (iii)
- a person and a trust, if the person is an MIB of the trust, or would otherwise be affiliated with an MIB of the trust (if the first part of this rule did not apply s. 251.1(1)(g).<sup>186</sup>

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<sup>183</sup> Control, in the affiliation context, refers to *de facto* control.

<sup>184</sup> Subparagraph 251.1(4)(d)(iv) of the *ITA*.

<sup>185</sup> Note: "Controlled" for the purposes of section 251.1 means controlled, directly or indirectly in any manner whatever. *De facto* control must therefore be ascertained.

<sup>186</sup> For example, where trusts A and B have a common MIB (Mr. X), trust A will not qualify as a person that would be affiliated with an MIB of trust B without reference to paragraph 251.1(1)(g) as the reason that trust A is affiliated with Mr. X is that Mr. X is an MIB of trust A. Affiliation would therefore not be established under paragraph 251.1(1)(g).

- two trusts, if a contributor to one of the trusts is affiliated with a contributor to the other trust and
  - an MIB of one of the trusts is affiliated with an MIB of the other trust,
  - an MIB of one of the trusts is affiliated with each member of an MIGB of the other trust, or
  - each member of an MIGB of each of the trusts is affiliated with at least one member of an MIGB of the other trust: s. 251.1(1)(h).

A contributor is defined in subsection 251.1(3) as a person who has made a loan or transfer of property to the trust, unless the person deals at arm's length with the trust at the time and is not, immediately after, an MIB in respect of the trust. It is of note that two trusts will not be affiliated solely because they share a trustee due to the application of paragraph 251.1(4)(c).

Furthermore, for the purposes of subsection 251.1, persons are affiliated with themselves.<sup>187</sup> The CRA has confirmed that a person may be affiliated with themselves in different capacities (e.g., as a trustee and as a shareholder).<sup>188</sup> Furthermore, in determining whether a person is affiliated with a trust, the person's interest as a beneficiary will be disregarding in determining whether the person deals at arm's length with the trust.<sup>189</sup>

The definitions of MIB and MIGB are provided for in subsection 251.1(3) of the *ITA*, and require aggregation of interests held by affiliated persons. Subsection 251.1(3) defines MIB of a trust, at any time, as a person whose interest as a beneficiary, if any, at that time in the income of the trust has, together with the interests as a beneficiary in the income of the trust of all persons with whom the person is affiliated, a fair market value that is greater than 50% of the fair market value of all the interests as a beneficiary in the income of the trust. A person will also be an MIB if the test would be met if the word "income" were replaced with the word "capital". In other words, where a beneficiary has, together with persons with whom it is affiliated, 50% of the fair market value of all of the income interests or capital interests in the trust, that person will be an MIB.

The inclusion of the words "if any" in subsection 251.1(3) reflects Parliament's intention that a person need not be a beneficiary of a trust in order to be an MIB in respect of it.<sup>190</sup> For example, if the fair market value of the capital interest in a trust held by a Mr. X's spouse (who is affiliated with Mr. X pursuant to paragraph 251.1(1)(b)) exceeds 50% of the fair market value of all of the capital interests in the trust, both Mr. X and his spouse would be MIBs in respect of the trust as both would meet the test set out in subsection 251.1(3). There is, however, a specific provision in the *ITA* noting that a trust will *not* be an MIB of another trust unless the trust has an interest as a beneficiary of the other trust.<sup>191</sup>

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<sup>187</sup> Paragraph 251.1(4)(a) of the *ITA*.

<sup>188</sup> CRA, Views, Technical Interpretation, "2000-0024775 – Affiliated rules and trusts" (23 February 2001).

<sup>189</sup> Subparagraph 251.1(4)(d)(ii) of the *ITA*.

<sup>190</sup> Note the deletion of the words "if any" in the definition of MIB for the purposes of section 251.2 of the *ITA*.

<sup>191</sup> Subparagraph 251.1(4)(d)(iii) of the *ITA*.

Persons can become affiliated with trusts in a variety of ways. If the trust controls a corporation, the trust and corporation will be affiliated.<sup>192</sup> A trust is affiliated with its MIBs.<sup>193</sup> A person is also affiliated with a trust if the person would be affiliated with an MIB of the trust without reference to paragraph 251.1(1)(g) of the *ITA* as explained above.

Subparagraph 251.1(4)(d)(i) of the *ITA* contains a look-through rule for the purposes of determining affiliation. Specifically, where a trust is discretionary and the trustee has the power to allocate income or capital among a class of beneficiaries, subparagraph 251.1(4)(d)(i) of the *ITA* deems the discretionary power to be fully exercised in favour of the person in question for the purposes of determining MIB status. This can result in a person being treated as an MIB, and thus affiliated with the trust, even if they have not actually received any distributions (and, perhaps, never will).

Note that the application of subparagraph 251.1(4)(d)(i) will not necessarily result in each beneficiary of a discretionary trust being deemed to be an MIB. For example, depending on the facts, it may be that the fair market value of a beneficiary's interest would not exceed 50% of the fair market value of all of the interests in question, even if the trustee's powers are fully exercised. For example, where the beneficiary's interest is contingent on the passing of other individuals, the fair market value of their interest may remain low, as even the full exercise of the trustee's powers would not enable them to making distributions to such beneficiaries until the other individuals pass. As such, the beneficiaries may not be MIBs.<sup>194</sup>

### (c) Association

The concept of "associated corporations" in Canadian tax law is governed by section 256 of the *ITA*. The association rules are critical for determining whether corporations must share certain tax benefits, including the small business deduction.

Subsection 256(1) of the *ITA* sets out the primary circumstances in which corporations are considered associated. These include situations where one corporation controls another, both are controlled by the same person or group, or where related persons or groups have significant cross-ownership (generally, at least 25% of shares of any class, other than a specified class) in each corporation. More specifically, one corporation is associated with another pursuant to subsection 256(1) of the *ITA* if, at any time in the year:

- One of the corporations controlled<sup>195</sup> the other.
- Both of the corporations were controlled by the same person or group of persons.
- Each of the corporations was controlled by a person and the person who controlled one of the corporations was related to the person who controlled the other, and either of those

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<sup>192</sup> Subparagraph 251.1(1)(b)(i) of the *ITA*.

<sup>193</sup> Subparagraph 251.1(1)(g)(i) of the *ITA*.

<sup>194</sup> CRA, Views, Interpretation—Internal, “2019-080369117 – 69(11)—majority interest beneficiary” (2 October 2019).

<sup>195</sup> Note: the language used in subsection 256(1) of the *ITA* is “directly or indirectly in any manner whatever”. As such, *de facto* control must be considered.

persons owned, in respect of each corporation, not less than 25% of the issued shares of any class (other than a specified class.)

- One of the corporations was controlled by a person and that person was related to each member of a group of persons that controlled the other corporation, and that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class (other than a specified class.)
- Each of the corporations was controlled by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class (other than a specified class.)

Subsection 256(1.2) of the *ITA* provides rules for determining control through indirect ownership, including through trusts. As previously noted, where shares are owned by a trust, the control is attributed to the trustees, as they have legal ownership of the shares and the right to vote.

When a trust owns shares of a corporation, the *ITA* contains "look-through" rules in paragraph 256(1.2)(f) to attribute ownership of those shares to the trust's beneficiaries for the purposes of the association rules. These rules depend on the nature of the trust in question; specifically, whether it is discretionary or non-discretionary in nature. Where the beneficiary's share is not subject to a discretionary power, the beneficiary is deemed to own a proportion of the shares based on the fair market value of their beneficial interest relative to all beneficial interests in the trust.

Where, however, a beneficiary's share of the trust's income or capital depends on the exercise of a discretionary power by any person, then each such beneficiary is deemed to own all of the shares held by the trust. This means that, for discretionary trusts, more than one beneficiary can be deemed to own 100% of the same shares at the same time for the purposes of the association rules.<sup>196</sup> Furthermore, where shares are owned by a child under 18 years of age, the shares are deemed to be owned by their parent for the purposes of the association rules unless, having regard to all the circumstances, it can reasonably be considered that the child manages the business and affairs of the corporation without a significant degree of influence by the parent.<sup>197</sup> Consequently, where a beneficiary of a discretionary trust is under 18 years of age, that child's parents will be deemed (for the purposes of determining association) to own 100% of the shares held by the trust in question. This may lead to association between the corporation controlled by the trust and the corporations controlled by the parents of the beneficiary child. Note, however, that shares will not be subject to double counting where a parent has multiple children that are beneficiaries of the trust.<sup>198</sup>

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<sup>196</sup> *Moules Industriels (C.H.F.G.) Inc. c. La Reine*, 2018 TCC 85 ("*Moules Industriels*") and CRA, Views, Technical Interpretation—External, "2001-0104745 – Associated Corporations" (25 October 2001).

<sup>197</sup> Section 256(1.3) of the *ITA*.

<sup>198</sup> CRA, Views, Interpretation—External, "2015-0608781E5-T – Associated corporations—discretionary trust (Unofficial Translation) (8 December 2015).

The fact that a beneficiary's right to receive income or capital from a trust is subject to a future condition would not affect that person's status as a beneficiary of the trust. This position is supported by the CRA, which has stated that:

... it is our view that subparagraph 256(1.2)(f)(ii) would apply to deem the children named as beneficiaries under the terms of the trust as owners of the shares during the period of time before they attain the age of majority, even though their right to receive income or capital from the trust was conditional on their attaining the age of majority. Our view would be the same regardless of whether they were actually named as beneficiaries of the trust or were, subject to the condition that they attain the age of majority, members of a class of beneficiaries named in the terms of the trust.

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While such a beneficiary may not be entitled to receive any income or capital at that time, it would be incorrect to say that such a beneficiary's share of the accumulating income and capital of the trust at that time was not dependant on the exercise or failure to exercise discretion with respect to distributions from the trust. To the extent that the trustee chooses to retain the income earned by the trust in a particular year, the amount of capital available for distribution in the future, including the time when those beneficiaries reach the appropriate age to be considered for possible distributions, would be greater. Thus, the amount of their share of the accumulating income and capital of the trust does depend on the decisions made by the trustee with respect to the discretionary powers granted to that trustee.<sup>199</sup>

The actual legal control of the corporation whose shares are held by a trust typically resides with the trustee(s), as they exercise the voting rights attached to the shares. The Supreme Court of Canada in *Consolidated Holding Co.* confirmed that control of a corporation, the majority of whose voting shares are owned by a trust, rests with the trustee or group of trustees that can bind the trust. However, for the purposes of the association rules, the look-through rules operate in parallel, deeming the beneficiaries to own the shares as described above. This can result in simultaneous control by both the trustee(s) and the deemed beneficiary owners.<sup>200</sup>

The leading case on this issue is *Moules Industriels (C.H.F.G.) Inc. c. La Reine*.<sup>201</sup> In this case, the Tax Court of Canada held that where a trust is discretionary (i.e., the trustee has discretion as to the allocation of income or capital among beneficiaries), each beneficiary subject to that discretion is deemed to own all of the shares held by the trust, regardless of any limitation in the trust deed regarding the maximum amount that can be distributed to a beneficiary. The Court rejected arguments that the deemed ownership should be prorated based on such limitations, emphasizing that the statutory language does not provide for such prorating. It is of note that the language in subparagraph 251.1(4)(d)(i) relating to the look-through rule in the affiliation

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<sup>199</sup> CRA, Views, Interpretation – External, “2005-0112511E5 – Association: shares held in discretionary trust for minors” (May 2, 2006). See also CRA, Views, Conference, “2004-008689 – Discretionary Trusts and Associated Corporations” (8 October 2004).

<sup>200</sup> CRA, Views, “IT-64R4 (Consolidated) – Corporations: Association and Control” (14 August 2001) (Archived).

<sup>201</sup> *Moules Industriels*, *supra* note 196.

context is different and that the result may well have been different in the context of the test for affiliation.

This means that, for association purposes, if a discretionary trust owns shares of a corporation, each discretionary beneficiary is deemed to own all of those shares. This can result in multiple corporations being associated if, for example, a beneficiary controls another corporation directly or through another trust. The application of the rules also means that more than one person can be deemed to own the same shares at the same time. If a discretionary trust owns shares of two corporations, and a beneficiary is deemed to own all the shares of both, the corporations may be associated under paragraph 256(1)(b) of the *ITA*. Furthermore, if a beneficiary of a discretionary trust is also a direct or indirect controller of another corporation, the look-through rules may cause the corporations to be associated under paragraphs 256(1)(c), (d) or (e), depending on the relationships and shareholdings.

The *ITA* contains some useful exceptions in this respect. Subsection 256(5) notes that, if a corporation is controlled by a corporate trustee, the two corporations (the one controlled by the trust and the corporate trustee itself) are not associated unless, at any time in the year, a settlor of the trust controlled or was a member of a related group that controlled the trustee corporation. Subsection 256(4) of the *ITA* provides that if two corporations are controlled by the same executor, liquidator or trustee due to the death of their respective controlling shareholders, they are not associated solely for that reason, unless the control arises from estates or trusts created by the same individual or by individuals not dealing at arm's length. These exceptions, though useful, will only be applicable in limited circumstances.

## **6. An Update on the Meaning of Paid or Payable for the Purposes of Subsections 104(6) and 104(24)**

We conclude with an update on the deductibility of distributions from trusts to beneficiaries and the meaning of the term “payable” for the purposes of subsections 104(6) and 104(24) of the *ITA*.

Broadly, paragraph 104(6)(b) of the *ITA* allows a trust to deduct from its income for a taxation year “the part of its income...for the year that became payable in the year to ... a beneficiary...” A deduction pursuant to paragraph 104(6)(b) is therefore only available in respect of amounts that are actually “payable” to beneficiaries in the year.<sup>202</sup> The term “payable” is not defined in the *ITA*.

Subsection 104(24) of the *ITA* provides that, for the purposes of subsection 104(6) (and other related provisions), an amount is deemed not to have become payable to a beneficiary in a taxation year unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of it.

Subsection 104(24) does not have the effect of deeming an amount that would not otherwise be payable to be payable if it meets one of the criteria set out in subsection 104(24); rather, it has the effect of rendering an amount that would otherwise be considered to be payable to *not* have

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<sup>202</sup> A deduction is also available in respect of amounts included in a beneficiary's income pursuant to subsection 105(2) of the *ITA*.

become payable unless it was paid to the beneficiary in the year or the beneficiary was entitled in the year to enforce payment of it.<sup>203</sup> While the CRA's administrative policy had previously been to accept that an amount was payable for the purposes of subsection 104(6) where subsection 104(24) was not invoked (that is, the amount had been paid in the taxation year to the beneficiary or the beneficiary was entitled in the taxation year to enforce payment)<sup>204</sup>, it has since begun to require both that the amount be payable and that subsection 104(24) not be invoked.

In *Maurice Kissel Family Trust v. The King*,<sup>205</sup> Hogan J. clarified the meaning of "payable" for the purposes of paragraph 104(6)(b) of the *ITA* in the context of trust income allocations to minor children who are "designated persons" for the purposes of the *ITA*. In *Kissel*, the trust was a personal family trust with two minor children as beneficiaries. The trust deed specifically prohibited any minor beneficiary from receiving or using any income or capital from the trust while they were a "designated person" in respect of their father, who was also the trustee. Despite this clear prohibition, the trust realized a substantial capital gain from the sale of shares in a small business corporation and paid \$100,000 to each minor beneficiary in the same taxation year. The trust claimed a deduction under paragraph 104(6)(b) of the *ITA* in respect of these payments, and the children included the amounts as income under subsection 104(13).

The CRA reassessed the trust, denying the deduction on the basis that the amounts had not become "payable" as required by paragraph 104(6)(b) of the *ITA*, since the trust deed expressly prohibited such payments to the minors. Instead, the CRA included the amounts in the minors' income under subsection 105(1). The central legal issue before the Tax Court of Canada was whether the amounts paid to the minor beneficiaries were "payable" within the meaning of paragraph 104(6)(b) of the *ITA*, given the explicit prohibition in the trust deed.

The Court held that if the terms of the trust prohibit a payment to a beneficiary, then the amount cannot be considered "payable" for the purposes of paragraph 104(6)(b). The Court rejected the argument that the term "payable" should be interpreted broadly to include amounts paid in violation of the trust, distinguishing this from the tax treatment of illegal income, which is based on the broad definitions of "business" and "profit" in the *ITA*.

*Kissel* therefore confirms that, for an amount to be "payable" under paragraph 104(6)(b) of the *ITA*, it must be permitted by the terms of the trust. If the trust deed prohibits the making of a payment, the amount is not "payable" even if it is actually paid.

The comments in *Kissel* are consistent with the analysis of the court in *Fiducie Historia c. Le Roi*.<sup>206</sup> In *Fiducie Historia*, payments from a trust to beneficiaries were allegedly made in contravention of the governing trust deed and the *Civil Code of Quebec*. While the Court ultimately concluded that the *Civil Code of Quebec* had not been contravened and that the

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<sup>203</sup> See *Kissel*, *supra* note 5. This is consistent with the CRA's longstanding policy. For example, see CRA, Views, Interpretation—Internal, "2005-0159081I7 – Timing of Income Inclusion for Trust Beneficiary" (March 3, 2006) and CRA, Views, Conference, "2006-0185631C6 – Interaction of 104(24) and 104(24)" (11 September 2006). However, also see *Cole v. Minister of National Revenue*, [1980] C.T.C. 3027, 81 D.T.C. 8.

<sup>204</sup> See CRA, Views, Interpretation—Internal, "2005-0159081I7 – Timing of Income Inclusion for Trust Beneficiary" (March 3, 2006) and CRA, Views, Conference, "2006-0185631C6 – Interaction of 104(24) and 104(24)" (11 September 2006).

<sup>205</sup> *Kissel*, *supra* note 5.

<sup>206</sup> *Fiducie Historia c. Le Roi*, 2024 CCI 76 ("*Fiducie Historia*"). We note that this case is currently under appeal.

amounts were, indeed, payable, the Court in *Fiducie Historia* suggested that, where an amount is paid in contravention of the governing trust indenture or the applicable legislation, it would not be considered to be “payable” for the purposes of subsection 104(6). Notably, the Court took the position that the payment of an amount to a beneficiary was not sufficient to render it deductible for the purposes of subsection 104(6). *Fiducie Historia* is presently under appeal.

The decisions in *Kissel* and *Fiducie Historia* align with the CRA’s longstanding administrative position and technical interpretations, which generally require trustees to ensure that any allocation of income to beneficiaries, for which a deduction is claimed under 104(6)(b), is actually permitted by the trust instrument. For example, in a 2016 Technical Interpretation,<sup>207</sup> the CRA considered a fact pattern that was very similar to *Kissel*. Specifically, distributions were made to minor beneficiaries while they were “designated persons” in respect of their father, contrary to the terms of the trust indenture in question. The CRA noted that:

In our view, it is *prima facie* not possible, pursuant to subsection 104(6), for an amount to become payable in the year to a beneficiary that is a designated person under the terms of the trust indenture. The requirement of subsection 104(6) is simply not met for the particular taxation year. Accordingly, in this circumstance, no amount is deductible to the trust pursuant to subsection 104(6) for the particular taxation year in respect of the payments to the minors.

There is therefore strong authority that, in order for an amount to be considered to be “payable”, it must not be paid in contravention of a trust deed. This, however, is not sufficient to qualify an amount as being “payable” for the purposes of subsection 104(6). In a 2010 Roundtable<sup>208</sup>, the CRA referenced an older ruling<sup>209</sup> in providing the following general guidance regarding the meaning of the term “payable”:

With respect to trustees exercising discretion before the end of the year:

i. In order for the income of a discretionary trust to become payable in a taxation year to the beneficiaries of the trust, the trustees are required to exercise their discretion before the end of the trust's taxation year and the exercise of discretion must be irrevocable with no conditions attached to the beneficiaries' entitlement to enforce payment of the amount in the year. The apportionment of the trust's income to each beneficiary (e.g., all the income, a fixed percentage of the income, or a set amount) must also be established.

ii. It is our view that the beneficiaries must be advised before the end of the trust's taxation year of the trustees' decision, including the apportionment of the trust's income to which the beneficiary is entitled in the year to enforce payment, even if the actual amount is not known...

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<sup>207</sup> CRA, Views, Interpretation—Internal, “2016-066397117 – 104(6)(b), Whether Amounts Became Payable” (1 November 2016).

<sup>208</sup> CRA, Views, Conference, “2010-0363071C6 – STEP Roundtable Q2” (8 June 2010).

<sup>209</sup> CRA, Views, Memo, “9529647 – Promissory note-discretionary trust amount payable” (26 February 1997).

iii. The fact that the actual amount of the income of a trust in a year cannot be ascertained until after the end of the trust's taxation year due to administrative delays in obtaining the necessary information will not, in and by itself, result in an amount apportioned to a beneficiary in the year based on that income not being payable to the beneficiary in the year (as supported by the case *Ginsburg v M.N.R.*, [1992] 2 C.T.C. 2152 (T.C.C.) 92 D.T.C. 1774). However, where the income of a trust is not ascertainable at the year end because the amount of such income is dependent on some contingency or event occurring after that time, then ... it is our view that, depending on the circumstances, a beneficiary may not have an enforceable right to demand payment of such an amount in that year.

In *Ginsberg* (referenced by the CRA above), the Court held that that the beneficiary in question was entitled *in the year* to enforce payment of the income generated by her husband's estate, despite the fact that the income had not been ascertained at the end of the year. The beneficiary was the sole beneficiary entitled to receive the income of the estate in the year in question. At paragraph 20 of *Ginsberg*, the Court noted the following:

In my opinion the appellant was entitled to enforce payment of the amounts for which she has been assessed ... in those years within the meaning of subsection 104(24) of the Act. Under the will the appellant was entitled to net income from the residue of the estate ... Her entitlement to that income and hence her entitlement to enforce payment arose as the funds generated by the assets of the trust became its property...

In *Evans et al. v. The Attorney General of Canada*,<sup>210</sup> delay in ascertaining the amounts "payable" to beneficiaries put the taxpayer trust in a very different position.

In *Evans*, an individual ("Gary") had owned shares in two corporations (the "Edson Corporations") personally. On the advice of his professional advisors, Gary participated in a freeze transaction whereby his common shares in each of the Edson Corporations were exchanged for fixed value preferred shares while new common shares were issued to a new family trust, the Evans (2009) Family Trust (the "Evans Trust") for the benefit of Gary, his spouse, his two children and a third corporation.

In 2012, the shares of the Edson Corporations were sold resulting in a capital gain to the Evans Trust. The trustees of the Evans Trust invested the sale proceeds in an investment portfolio to generate additional income.

In 2012, the lifetime capital gains exemption could shelter a maximum of \$750,000 of gains from taxation. As such, the trustee's instructions to his advisors involved an allocation of a minimum of \$375,000 to each of the trustee's spouse and two sons. A resolution (the "Evans Resolution") was drafted; however, it did not specify the taxable gains to be allocated to the beneficiaries. Rather, it simply indicated that the income of the Evans Trust was to be allocated to the beneficiaries by way of demand promissory note in the amounts to be determined when the income of the Evans Trust was ascertained. The Minister reassessed the Evans Trust on the basis that the income allocated to the beneficiaries should be taxed in the Evans Trust as the Evans

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<sup>210</sup> *Evans, supra* note 6.

Resolution was “not sufficiently specific to allocate at least \$375,000 of taxable capital gains to each beneficiary in 2012.”<sup>211</sup> The trustee of the Evans Trust applied for rectification of the Evans Resolution. The Attorney General of Canada opposed the application.

Rady J. of the Ontario Superior Court found that the evidence established an agreement to allocate at least \$375,000 (equal to the taxable capital gains deduction) to each of the three beneficiaries. However, there was insufficient evidence to show that the entire taxable capital gain was agreed to be allocated to them.<sup>212</sup>

As a result, the Court granted an order rectifying the Evans Resolution to specify that \$375,000 of the taxable capital gain was to be allocated to each beneficiary. Rady J. emphasized that the applicants were not seeking to retroactively amend their agreement to achieve beneficial tax consequences, but rather to correct the Evans Resolution so it accurately reflected the agreement that had been reached.

The Court also rejected the argument that the application should be dismissed because the trust could simply sue its professional advisors. Rady J. cited, with approval, the dissenting reasons of Abella J. in *Canada (Attorney General) v. Fairmont Hotels Inc.*,<sup>213</sup> noting that courts should not force parties to pursue alternatives that are neither practical nor certain.

*Evans* confirms that rectification may be available to correct trust resolutions where ascertained distributions are not properly documented. In determining that a written resolution does not accurately reflect the parties’ actual agreement, Courts are very likely to require evidence supporting the existence of communications with beneficiaries and agreement among the parties. The case also clarifies that the mere existence of an alternative remedy (such as a professional negligence claim) does not preclude rectification where it is otherwise appropriate. This is helpful for those circumstances in which resolutions are not properly drafted so as to make amounts “payable” to beneficiaries. Had the beneficiaries in *Evans* not been made aware of the proposed distribution, however, the outcome of the case may have been different.

As previously noted, subsection 104(6) allows a trust to deduct an amount that is “payable” to a beneficiary in a year. Subsection 104(13) of the *ITA* requires a beneficiary to include in their income for a taxation year such part of the trust’s income for its taxation year that became payable to the beneficiary in that year (subject to certain exceptions). As such, the trust benefits from a deduction in respect of the amount while the beneficiary includes the amount in their income. If the amount was not “payable”, however, it is not deductible by the trust in subsection 104(6) and is not included in the beneficiary’s income under subsection 104(13). Instead, where a beneficiary receives an amount from a trust that is not otherwise included in their income, subsection 105(1) of the *ITA* may apply.<sup>214</sup> This provision includes in a taxpayer’s income the value of all benefits to a taxpayer during a taxation year from or under a trust.

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<sup>211</sup> *Ibid* at paragraph 30.

<sup>212</sup> In *Evans*, the promissory notes that were ultimately prepared reflected a distribution of all of the income of the Evans Trust and were in the amounts of \$726,769.33, \$529,274.38 and \$488,560.30.

<sup>213</sup> *Canada (Attorney General) v. Fairmont Hotels Inc.*, 2016 SCC 56.

<sup>214</sup> Subsection 105(1) provides, broadly, that the value of all benefits to a taxpayer during a taxation year from or under a trust, irrespective of when created, is to be included in computing the taxpayer’s income for the year except to the extent that the value is otherwise required to be included in computing the taxpayer’s income for a taxation

The inclusion in a beneficiary's income of an amount under subsection 105(1) does not depend on the deductibility of the amount by the trust. As such, where the trust is unable to claim a deduction in respect of an amount distributed to a beneficiary, both the trust and the beneficiary may be taxed on the amount in question. (The trust is taxed on the amount when it is earned as income. The beneficiary is taxed on the receipt of the amount from the trust. As no deductions are permitted to the trust, the amount in question may be taxed twice). In *Kissel*, Hogan J. noted that the taxation of the amount in question in the hands of the beneficiary under subsection 105(1) when a corresponding deduction is not available to the trust did not constitute double taxation, citing the Federal Court of Appeal in *Ascot Enterprises v. R.* for the premise that "[d]ouble taxation exists when a single payment is taxed twice in the hands of the same beneficiary."<sup>215</sup> As, in this case, the same amount is being taxed by two different taxpayers, double taxation (arguably) does not exist. Nonetheless, this is not a good result for the taxpayers.

The *Kissel* case underscores the need for trustees to ensure that any distributions or allocations of income to beneficiaries are authorized by the terms of the relevant trust if they wish to claim a deduction under paragraph 104(6)(b) of the *ITA*. The mere fact that an amount has been "paid" does not make it "payable" for the purposes of paragraph 104(6)(b). Practically, this means that trustees cannot circumvent the terms of a trust to achieve tax benefits (as the taxpayers appear to have attempted to do in *Kissel*) without risking the imposition of tax on the distributed amount in the hands of the beneficiaries without a corresponding deduction being available to the trust.

Where, however, errors are made (as in *Evans*), rectification is a remedy that may cure deficiencies in documentation to enable trusts to access the subsection 104(6) deduction. However, this remedy may only be available where it is possible to establish that the documents, as drafted, do not reflect the true agreement of the parties. As *Evans* makes clear, the Attorney General is willing to oppose applications of this nature.

## 7. Conclusion

As noted, many of the traps discussed in this paper are not new. However, they are not necessarily intuitive or obvious and, as such, may catch practitioners unawares. In light of the increased scrutiny that may result from the enhanced trust reporting rules, practitioners should endeavor to keep them top of mind. This is especially the case when a reorganization involving trusts is undertaken or where the trust, itself, is restructured.

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year; or has been deducted under paragraph 53(2)(h) in computing the adjusted cost base of the taxpayer's interest in the trust or would be so deducted if that paragraph applied in respect of the taxpayer's interest in the trust.

<sup>215</sup> *Ascot Enterprises v. R.*, [1996] 1 CTC 384 (FCA).