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PRE-EMPTIVE STRIKE RESTRICTING ATTACKS ON THE TRUST

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PRE-EMPTIVE STRIKE –
RESTRICTING ATTACKS ON THE TRUST

I. INTRODUCTION

The great American legal scholar Austin Scott, in the introduction to his seminal work on the Law of Trusts, pronounced, without a hint of qualification, that the development of the concept of the trust was one of the great creations of English common law. Indeed, some commentators would argue that the trust concept, as the significant building block in the evolution of sophisticated property law, was a major factor in propelling the world to the forefront of a highly evolved commercial system which ultimately has permitted the tremendous technological transformations occurring in our own time. These and other heady claims for the major influence of the trust may be debated but there can be little doubt that the multi-faceted use of the trust is unrivalled by almost any other property or commercial vehicle or entity.

The omnipresent use of the trust is seen in our everyday dealings and lexicon; most everyone today has variously had contact with a "trust company"; a " trust officer" a "deed of trust" a "family trust" an "executor and trustee" and numerous other entities and vehicles bearing the name trust. Given the influence and utility of the trust, one would think that most of us would be able to give at least a basic explanation of the origins of a trust and what it is. That, I suspect is not the case and even those professionals who work with trusts for their livelihood probably do not give its history or conceptualization a moment's thought. But for those of us working in the area of trusts, it is important from time to time to step back and reflect on these issues, not only as a matter of interest, but because it ultimately is helpful for understanding the various needs of customers and clients. For example, the fact that the trust was the actual creature of the courts is important to bear in mind because it anchors the trust in the very heart of the legal, as opposed to the commercial structure. This has all kinds of implications, perhaps most generally expressed as the courts continued insistence that they have an abiding interest in the monitoring of and if necessary, intervention in the trust.

At this Conference we will be discussing the various types and uses of trusts and also some of the pitfalls which can lead to a successful attack on a trust. My comments, like those of my colleagues, will touch on these different considerations, but I also thought it useful to give a brief introduction to the history of the trust which might permit some of the more detailed discussion to be put into a larger context.

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II. THE DEVELOPMENT OF THE TRUST CONCEPT

A. TRUST DEFINED

A simple definition of a trust is that it is a legally recognized form of property holding by which there are two different types of title - legal and beneficial. Those who administer the trust property are vested with "legal" title while those actually benefiting from the property are vested with "equitable" or beneficial title. Another classic definition can be found in any number of trust texts as follows:

> A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of persons (who are called beneficiaries, or *cestui que trust*), of whom he may himself be one, and any one of whom may enforce the obligation. Any act or neglect on the part of a trustee which is not authorized or excused by the terms of the trust instrument, or by law, is called a breach of trust. (Underhill's Law of Trusts and Trustees 12th Edition page 3).

In all of the various definitions of a trust the basic element of a "split" in property ownership is apparent. And while it strikes us as basic today, it was a form of property ownership which took hundreds of years to evolve and be fully recognized.

B. ORIGINS OF TRUST

The trust's origins can actually be traced to a response to the ossification of England's legal system which, in the early Middle Ages, had no ability to recognize at law more than the most basic type of property ownership. So, for example, if an individual gave property to another for safekeeping, expecting its benefits or return on demand and the safekeeper refused claiming ownership, the law had limited capacity to compel the return of property to the original owner. By reason of this perceived type of inequity in the legal system of the time, various mechanisms for solutions slowly began to emerge.

C. COURTS OF EQUITY

In brief and condensing hundreds of years of English property law history, it is sufficient to point to the emergence of the position of Lord Chancellor as the recipient of petitions for fair or equitable decision-making, which in effect overruled the inflexible law codes of the time. The Lord Chancellor emerged as the "conscience" of the kingdom and over time his one-off decisions overruling the law of the day developed into a parallel court system, known as the chancery courts or courts of equity. By the end of the reign of Henry V (early 15th century) the court of chancery had become well established. Incredibly, these two courts systems (the courts of law and the courts of chancery) functioned simultaneously for hundreds of years resolving to

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some extent the eternal conflict between the need for certainty and predictability with the need for flexibility. Finally, in the 19th century, the courts of law and the courts of equity were merged into a single system such that the equitable principles that had been developed to deal with the limitations of a too rigid legal system became the hall mark of the Anglo/Canadian/American judicial systems. The development of the concept of the trust, where legal title and equitable or beneficial title were recognized by the chancery courts were these courts greatest contribution.

Because it was the decisions of the courts of chancery which recognized the various situations where property ownership could be split, it was in these courts that the administration of trusts actually developed. It was these courts that exercised a supervisory jurisdiction which has sometimes been referred to as inherent jurisdiction. It is this jurisdiction which the courts have relied upon to intervene in the management and administration of trusts such as when a trustee wrongfully declines to act, or is acting improperly or where difficulties arise which cannot be removed without the assistance of the court:

> Courts of equity have original, general and inherent jurisdiction over trusts and the administration thereof, to the end that beneficiaries incapable of looking out for themselves may be protected against the fraud, incompetency or neglect of the trustee. The scope of an equity court's supervisory control, includes, of necessity, any matter which concerns the integrity of the trustees, its administration, its preservation and its disposition and any other matter wherein its officers are affected in the discharge of their duties (American Jurisprudence (2d) Vol. 76, 332).

III. ESTATE LITIGATION

A. TESTAMENTARY RELATED LITIGATION

1. Testamentary Freedom

A cursory review of legal texts could give the impression that this area of the law is subject to technical and sometimes dry legal principles which have changed little over the centuries. Practitioners of estate litigation, however, know that it is this area of the law which arouses many emotions. It is also one of the few areas of law which every person at one time has to deal with, either upon giving instructions for a will or upon becoming an executor or a beneficiary. Unfortunately, there is still a large degree of ignorance as to inheritance rights, but even more significantly, even once those rights are known, the passions can run so deep that otherwise non-combative individuals may find themselves in litigation.

Most lawyers practising in this area have been asked from time to time by their clients whether there is anything that can be done when they find out about a will which treats them unfairly and the testator is still alive. Here, the answer is clear. There is little that can be done until the

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testator's death. This ability of a person to deal with their property while he or she is alive is referred to as testamentary freedom.

However, in many jurisdictions, including British Columbia, "testamentary freedom" does stop at death. In certain civil jurisdictions the law actually provides for the percentage of the estate to be left to a particular relative. In common law jurisdictions there is no such statutory regime. The closest our jurisdiction comes to statutorily mandated percentages is when there has been an intestacy (i.e., no will).

While the common law jurisdictions do not have a specific formula for estate distribution (which represents a check on testamentary freedom), they certainly do not embrace unbridled testamentary freedom in the sense that after the testator's death certain court mandated alterations in the testamentary scheme are permitted. What must be appreciated is that operating in our jurisdiction, as in those other jurisdictions whose law is inherited from 19th century England, is a strong tension between freedom to do whatever one likes with one's property and the interests of society in ensuring that this freedom is not abused. The law has developed in at least four areas reflecting this tension which place a check on absolute testamentary freedom as follows:

2. Checks on Testamentary Freedom

(a) Age

Generally, a testator must be 19 years before he or she has the legal capacity to make an enforceable will. There are certain exceptions such as under-age marriage and those situations known as privileged wills, which would apply to members of the regular Canadian Defence Forces, seamen, or those in the course of a voyage.

(b) Testamentary Incapacity

In England, the land which esteemed individual property rights, it was recognized early on that a will made by a person not of "sound" mind, would not be a valid will. As was once said in a significant 19th century decision, in the case of a "raving mad-man" or of a "drivelling idiot", there is no difficulty in determining capacity. But:

> "Between such an extreme case and that of a man of perfectly sound and vigorous understanding, there is every shade of intellect, every degree of mental capacity. There is no possibility of mistaking midnight for noon; but at what precise moment twilight becomes darkness is hard to determine."

To assist in this determination, a set of governing principles were laid out in the still applicable case of Banks v. Goodfellow in 1870. These are:

(i) the testator must understand the nature of the act and its effect;

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(ii) the testator must understand the extent of his property;

(iii) the testator must be able to understand and appreciate the claims of those around him, to which he should be giving effect; and

(iv) there is no "disorder of the mind that shall poison his affections, pervert his sense of right, or prevent the exercise of his natural faculties - that no insane delusion shall influence his will in disposing of his property and bring about a disposal of it which, if the mind had been sound, would not have been made".

The case is significant because the court holds that there is a standard of "morality" which most testators naturally ascribe to. If that which is expected as a matter of obligation or natural affection of the testator is displaced by reason of an "insane delusion", then the testator is held to be of unsound mind and those portions of the will which were directed by that unsoundness will fall. At the same time, however, the 19th century position, still cited in the context of incapacity challenges, holds that:

> "The law does not say that a man is incapacitated from making a will if he is moved by capricious, frivolous, mean or even bad motives ... he may disinherit, either wholly or partially, his children and leave his property to strangers to gratify his spite, or to charities to gratify his pride, and we must give effect to his will, however much we may condemn the course he has pursued."

The law, therefore, is somewhat ambiguous and would, subject to other legislative checks, appear to permit a disinheritance of e.g. a child by an individual who is just mean or ornery by nature but not if his otherwise sweet disposition had been transmuted by some kind of mental illness.

The essential point is that today, in the common law jurisdictions, what clients need to know is that it is difficult to challenge a will based upon incapacity. The reluctance by the courts to rush to find a determination of incapacity is in some measure a clear message that they are not interested in inviting attacks on wills because of perceived eccentricities of the aged or transient mental disturbances. The courts were always careful not to give a blank cheque to unhappy relatives to re-write wills. There was and continues to be recognition that often the only power the elderly holds is in disposing of their estate and the courts were and still are reluctant to undermine that power.

Having said that, however, I believe that the high threshold that must be met in attacking a will for lack of capacity continues to be applied by the courts because they know that there are other avenues available to address manifest unfairness in a will without having to throw out the entire document and revert to either a previous will, which can stand unchallenged, or an intestacy if there is no previous will. Parenthetically, this is an important point when considering a challenge on the basis of capacity. If a court finds that the testator was incapable of making a

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legal will, then the next preceding testamentary document is the one that governs. Obviously if the previous will leaves out the party that is challenging the current will, then the entire exercise may be for naught.

(c) Undue Influence/Suspicious Circumstances

A more common class of case is when there are circumstances so suspicious that it could lead a court to the conclusion that the testator actually did not know and approve of the contents of the will. So, for example, in a situation where the drafter of the will is the beneficiary, the doctrine of suspicious circumstances is invoked such that the beneficiary would have to remove the veil of suspicion. This doctrine is in some measure connected to principles of undue influence and fraud. While falling short of incapacity, undue influence can be invoked when the testator is vulnerable and dependent and where it can be shown that the beneficiary has so taken advantage of a position of authority or influence that the will does not represent the true intentions of the testator.

(d) Wills Variation Act

The main procedure today for the challenge of a will in British Columbia is a court application to **vary** the will (i.e. not set it aside) in accordance with the *Wills Variation Act* (other jurisdictions have their own similar type statute although there are some significant differences amongst them). It essentially allows a spouse or child to vary the terms of a will if the testator has not made "adequate provision for the proper maintenance and support of a surviving spouse and children". Our legislation permits a court to make an Order that it considers "adequate, just and equitable" to ensure that a testator discharges his or her moral duty as we would expect from a just spouse or parent as they case may be.

It is only the spouse and child now including common law spouses and children born in or out of wedlock and including children who have been adopted according to, for example, the *Adoption Act*, who are entitled to claim for a variation. While the class is restricted, it has to be emphasized that there is no restriction that the children who are varying the will be underage or dependent. Even adult, self-sufficient and wealthy children are not necessarily precluded from applying to vary a will. It is, however, the consideration of the circumstances and all of the circumstances which make this area of the law difficult to advise upon with any degree of certainty and which also allows a venue for all of the passions which family relationships can engender.

The extent of these moral obligations has been reviewed in the Supreme Court of Canada in the decision of *Tataryn v. Tataryn Estate* (1994), 93 B.C.L.R. (2nd) 145, such that the long-simmering controversy as to whether the legislation simply calls for a needs-based financial test or whether it was intended to take into account the broader definition of moral obligation has now been settled. Our highest court rejected the narrow needs-based test. In the course of giving this judgment, Madam Justice McLaughlin had the opportunity to review the origins of the British Columbia *Wills Variation Act* and made some germane observations:

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> "The statute, adopted in 1920, was modelled on New Zealand legislation. When the Bill was introduced, the Attorney General J.P. De B. Farris, described it as 'one of the links in the government's chain of social welfare legislation'. The Bill was the result of lobbying by women's organizations with the final power given to them through women's enfranchisement in 1916--It is recorded in the journals of the Legislative Assembly of B.C. that on proclamation of the Act, the Lieutenant Governor said that it 'will tend toward the amelioration of social conditions within the province..."

The origins of the legislation therefore, are interesting. On the one hand this law was part of larger welfare legislation which was intended to ensure that scoundrel husbands and fathers would not leave their wives and children to be wards of the state. The debates in the New Zealand legislature which enacted the first legislation of this type in the 1890's made it clear that there was a social problem of sufficient magnitude that required state intervention. What is more intriguing however, is the observation that the Bill was the direct result of lobbying by women's organizations.

Later in her Judgment, Madam Justice McLaughlin makes the point that there was nothing to suggest that the women's groups who lobbied for legislation intended that it be restricted to financial need. At page 151 Her Ladyship states:

> "... The desire of the legislators who conceived and passed it was to '**ameliorate** social conditions within the Province.' At a minimum, this meant preventing those left behind from becoming a charge on the state. But the debates may also be seen as foreshadowing more modern concepts of equality. The Act was passed at a time when men held most property. It was passed, we are told, as 'the direct result of lobbying by women's organizations with the final power given to them through women's and enfranchisement in 1916'. There is no reason to suppose that the concern of the women's groups who fought for this reform were confined to keeping people off the state dole. It is equally reasonable to suppose that they were concerned that women and children receive an 'adequate, just and equitable' share of the family wealth on the death of the person who held it, even in the absence of demonstrated need."

Madam Justice McLaughlin pointed out as well that the Act must be read in light of modern values and expectations:

> "Whatever the answers to the specific questions, this much seems clear. The language of the Act confers a broad

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> discretion to the court. The generosity of the language suggests that the legislature was attempting to craft a formula which would permit the courts to make orders which are just in the specific circumstances and in light of contemporary standards ... What was thought to be adequate, just and equitable in the 1920's may be quite different from what is considered adequate, just and equitable in the 1990's. This narrows the inquiry. Courts are not necessarily bound by the views and awards made in earlier times. The search is for contemporary justice."

So, for example, a court, in determining what would be a just and equitable variation of the will, would consider some of the following factors: (i) the size of the estate; (ii) the standard of living of all those involved; (iii) the relative financial, medical and other relevant needs of all parties involved; (iv) the degree of closeness, affection and intimacy with the testator over his or her life; (v) the health and mental capacity of all involved; (vi) their respective stations in life and their expectations, hopes and aspirations as encouraged by the testator; (vii) the character and views of the testator with respect to the claimant; (viii) any gifts or other assistance provided during the life of the testator; (ix) the contributions by those involved to building up of the estate, including any monetary or non-monetary contributions; (x) how the testator was cared for during his lifetime by those involved; (xi) any misconduct of or estrangement by the children and whether fault can be attributed to them; and (xii) an assessment of whether the testator's reasons for the gifts were rational or whether irrelevant considerations were taken into account.

This list is far from exhaustive and each category itself brings forth a consideration of other issues.

Because the *Wills Variation Act* allows for the relaxation of certain rules of evidence and because one can see that the entire family relationship becomes a relevant consideration, these kinds of cases under the *Wills Variation Act* are emotionally charged. Particularly in those situations where some children are treated more favourably under a will than others, it can be expected that all of the repressed or actual sibling rivalry will come to the fore; showing who is the "better" daughter or son and who is loved more is sometimes as much at issue as the money and property. It is no exaggeration to say that in some of these cases, the court process becomes a very expensive therapy. There are, however, a number of cases which are simply the product of second marriages and the competing claims on the testator by the children of the first marriage and the spouse of the second. There is no doubt that as the effects of divorce and remarriage work their way through the system, we will be seeing many more of these types of challenges.

3. Preventative Measures – Mediation – Litigation - Education

It is evident that a testator will be inviting conflict and discord to the family if he or she does not discharge basic moral parental and spousal obligations. If a testator thinks that they have valid reason for a disinheritance or a gift that otherwise falls short of "normal" expectation, the testator must not think that he or she can necessarily get around it by giving an explanation in the will.

While a court of course will want to know the testator's reasons for such a decision, if it is irrational or distorts the truth, it will be given little significance.

Because of the expensive and potentially traumatic nature of this kind of litigation, lawyers are attempting to promote alternative dispute resolutions such as mediation as an alternative to the courtroom.

In determining which procedure is most appropriate, many considerations come into play. For example, litigation is the most appropriate route to proceed where there are cases of fraud in an estate. Arbitration has certain advantages such as privacy but it has not become as accepted in estate litigation as mediation, which is qualitatively different from litigation and arbitration. Mediation is usually non-binding and uses a third party as a facilitator for the parties themselves to resolve their dispute. Mediation is a procedure which is often used to preserve a continuing relationship and can often be useful when a threshold question of entitlement or liability is not an issue but the monetary amount is. However, there are circumstances where mediation is not appropriate, such as if there is a need to off-set a power imbalance.

It is not uncommon to utilize different techniques as a case develops - so, for example, it may be necessary to commence an action and proceed through Discoveries, but then to move into a mediation, which in turn may not be entirely successful but might succeed in narrowing the issues which will ultimately result in some kind of settlement. There are, of course times when nothing short of a full trial is necessary. As such, litigation remains a tool, but not to the exclusion of other techniques. Experienced counsel should play a key role in advising as to which procedure is most likely to resolve the conflict in the most expeditious manner while at the same time obtaining the best possible result.

IV. TRUST RELATED DISPUTE RESOLUTION

A. USE OF MEDIATION AT THE PLANNING STAGE

The development of the trust created numerous legal challenges and disputes which contributed to much litigation. The different types of disputes are almost inestimable, although I will refer to some of the more common ones shortly. What can be stated with certainty is that the cost and energy of litigation has been enormous. Today in all aspects of our legal culture, a major transformation is occurring wherein the courts are being relied upon less and alternative forms of dispute resolution as has been discussed are increasingly invoked. While mediation is a form of dispute resolution which emerges as an alternative to trust litigation, I also wish to draw your attention to the possible use of mediation at the earliest stages of trust creation even before a full out dispute develops.

The use of an independent mediator during the initial structuring phase is in its infancy but those who have utilized same report a high degree of client satisfaction because of the reduction of the possibility of family litigation. The object, therefore, of using a mediator in estate planning is to eliminate future problems rather than to resolve outstanding litigation.

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The benefit of using an independent mediator is that it permits the disclosure of information during the planning when otherwise estate planners would have to rely upon incomplete or inaccurate data.

Most planning structures have not historically included potential trust beneficiaries or heirs as active participants. Those in close relationships may be reluctant to raise sensitive issues. Unfortunately, avoiding a problem usually results in future conflict. Accordingly, at the point that a practitioner sees potential conflicts the benefits of a skilled mediator ought to be considered. Some of the situations which we most amenable for an independent mediator are:

(a) divorce and multiple marriages;

(b) family business;

(c) children who may be mentally or physically challenged; or

(d) significant difference in economic circumstances.

B. ATTACKS ON A TRUST

1. The Essential Elements of a Trust

Firstly, it must be recognized that a trust is exposed to challenge if in fact it is a trust only in appearance and not in reality. The difficulties which can arise if the integrity of the trust is not maintained are manifold. While the circumstances which give rise to a challenge are varied, the principle line of attack is similar: the “trust” arrangement is intended to accomplish an overriding objective to defeat the legitimate legal claims of others. But this critique has accompanied the trust right from its birth when the prevailing legal sentiment was that the very concept of the trust was illegitimate. Those who resisted the development of the trust concept could not accept an almost metaphysical splitting of ownership of property which contradicted the hard facts. You will recall in my brief review of the development of the trust that the early English law could not conceive of a system of legal enforcement which recognized the ability of a person to own title to property without the full benefits of ownership. And no doubt, the resistance of the legal system was not only a conceptual inability to deal with more complex property holding arrangements, but a concern that this new development was potentially rife with abuse; property could be sheltered from taxing authorities or normal creditors simply by claiming that the real “beneficial” interest was owned by others.

So, the concerns that bedevil practitioners today, are in essence the result of the very nature of the trust itself and are not really new at all. It is for this reason that the essential purpose and requisites of a trust must be thoroughly understood so that the right “balance” can be struck in terms of achieving the client’s stated purpose with a legitimate trust vehicle.

Attacks on trusts frequently focus on the document creating the trust, that is its technical validity. A trust needs to clearly transfer property to a trustee for the beneficial use by third parties. A real interest in the property must be created or else the trust will be deficient. Consequently, the

language of the document must, with certainty, identify the intention to create a trust, the property which is included in the trust, and the beneficiaries of the trust. These elements are commonly referred to as the "three certainties". Additionally, a valid trust must lend itself to administration and be able to be settled. Finally, the object of the trust must be lawful.

In addition to the technical propriety of the enabling document, the conduct of the settlor and trustee or trustees will often attract the attention of the courts. A trust must also be administered by the trustee in such a way that it cannot be attacked as a sham. A trust cannot simply be a vehicle for the settlor or trustee to protect property that would otherwise be subject to legislation such as the *Family Relations Act*, the *Income Tax Act*, or the *Wills Act*, or to the demands of creditors.

The objective of the estate planner has been generally to advise a client on how best to preserve wealth both during lifetime and on death, taking into account the client's unique family and business situation and such external factors as the current tax and forced heirship regime. The move to locate trusts in jurisdictions other than where the settlor resides is of course motivated by a consideration of how these various individual and external factors play out together. Such factors as accessibility to the jurisdiction; the political climate of the settlor's own country and that of the proposed foreign situs can become most relevant (e.g the situation in Hong Kong beginning in the late 1980's); as well as the level of development of the banking and legal structure in the intended foreign jurisdiction. But whether the situs of the trust falls within a domestic or a foreign jurisdiction the overriding consideration is always whether the integrity of the trust can be maintained while fulfilling the stated objectives.

2. Fraudulent Conveyance Statutes

One of the most powerful tools available to those wishing to attack a trust are various types of fraudulent conveyance or preference statutes which have at their heart the protective role of ensuring property transfers do not offend the principle that arrangements such as trusts or gifts are not improperly used to avoid legal obligations. This legislative regime has been adopted in all common law jurisdictions and of course has gone hand in hand with the development of the trust precisely because of the possibilities for abuse. These statutes therefore ought to be seen as having been developed as the answer to those resistant to the use of the trust and stand as the essential corrective to abuse.

The first such protective legislation was enacted in 1571 and became known as An Act Against Fraudulent Deeds or the Statute of Elizabeth. In British Columbia, as in other jurisdictions, it is known as the Fraudulent Conveyance Act. The statute effectively declares as void any disposition of property made to delay, hinder or defraud creditors. Considerable jurisprudence has been developed to deal with the applicability of this statute; the essential question being at what point does the law recognize legitimate asset protection from that which is deemed to be unacceptable avoidance of creditors. In assisting in determining this balance, such presumptions as whether or not the settlor is insolvent at the time of the transaction or would render himself insolvent by reason of the transaction have been relied upon as assisting in the determination as to whether there is a dominant intent to defeat a creditor. The courts have in fact developed somewhat of a check list of the "badges of fraud" to assist in the ultimate determination

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including such considerations as: secrecy, whether or not the debtor actually retains control over the property, whether adequate consideration was exchanged, external financial pressures and the haste in which the transaction is conducted.

In actuality, what our commercial and legal systems have developed is a balance between encouraging the orderly structuring of affairs which could have the consequence of asset protection and the censure of transactions which are too overt in their dominant purpose to avoid the fulfillment of legal obligations. It could be argued in fact that the law penalizes those who do not have the resources to structure their affairs in the most sophisticated manner and in reality encourages asset sheltering providing it is done in a seemly and professional manner. While there may be some accuracy to this critique, the fact is that the use of trusts for asset sheltering have any number of motivating factors and is materially different from a deliberate scheme to avoid known or reasonably anticipated creditors.

In short, the fraudulent conveyance principles (which are also manifest in such statutes as the *Fraudulent Preferences Act* and the *Bankruptcy Insolvency Act*) are the corrective backdrop for the crafting of trusts. Particularly when moving into novel arrangements, all estate planning practitioners must be aware of the general legislative regime and the purpose for same. To assist the client and to minimize the risk that the practitioner might be found complicit in a fraudulent scheme, he or she ought to undertake the following:

(a) elicit all of the reasons for the transaction so that the same can be fully and properly documented;

(b) determine the financial circumstances of the settlor, past, present and those anticipated for the future so that appropriate advice can be given;

(c) if it appears that the dominant motivation is a fraud as defined by the statutes, the practitioner must so advise the settlor of the consequences and decline to act;

(d) even if the practitioner is satisfied as to the legitimacy of the proposed transaction, the settlor must always be advised of the possibility of attack, particularly if insolvency ensues in the future.

The actual details of the forms the legislation takes is well beyond the scope of this paper. Various jurisdictions have different forms of creditor protection. But for the purposes of this paper it ought to suffice to underscore the point that a careful consideration must always be given to the applicable fraudulent conveyance regime in any particular jurisdiction.

3. Defective Trusts: Words and Deeds

In *Rahman* v. *Chase Bank(C.I.) Trustco Ltd.*, (1991) J.L.R. 103 (Jersey), a settlor had created a revocable *inter vivos* trust with the intention of avoiding claims under Islamic Law by his wife and children. The settlor retained considerable control over the operation of the trust. Notable to the court was the fact that he could revoke the trust for his own benefit. In *Rahman*, the settlor's conduct in operating the trust was also of considerable importance. The evidence was that the

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trustee made no independent investment decisions and always took instructions from the settlor. The trustee was never given the proper control of the assets.

Rahman illustrates both aspects of a "bad" trust. The trust was not properly constituted, nor was it administered in such a way that it could be properly understood as a transfer of property from the settlor to the trustee in favour of the beneficiaries.

Some Canadian cases show how a trust may be technically valid, but how the administration by the trustee invalidates the trust.

In *Antflick* v. *Antflick*, [1980] O.J. No. 1240 (Ont. S.C. H.C. of J.), the sole reason given by the court for finding the trust to be a sham was the conduct of the husband involved in a matrimonial dispute. Although he was not the sole trustee, it was he who exercised complete control over the trust. The court was particularly unimpressed with the fact that he had encroached on the trust capital to arrange his tax affairs, but later claimed that the trust property was not a family asset to be divided upon the dissolution of his marriage. The court found that the trust was a sham and the assets in it were to form part of the erstwhile settlor's assets for the purposes of division in the family proceeding.

In *Circle P Paving* v. *912673 Ontario Inc.* (1997), 45 C.L.R. (2d) 317 (Ont. Gen. Div.), the degree of control the trustee exercised over the property of the trust, without regard to the other trustees and without making a proper accounts, led the court to rule that creditors who had a claim against her could execute against the trust assets. This, the court said, is regardless of whether the trust was properly constituted.

4. *Inter Vivos* vs. Testamentary Trusts

Inter vivos trusts can fail also where the benefits they bestow on the beneficiaries, and the beneficiaries themselves, are not properly determined until the death of the settlor. Often this occurs where the death of the settlor is a condition of the transfer of beneficial enjoyment of the trust assets. In such cases, the trust is regarded as a testamentary disposition rather than an *inter vivos* one. Testamentary trusts, of course, must comply with the *Wills Act* and provide less freedom to the testator than an *inter vivos* trust does to the settlor.

In fact, finding a gift to be a testamentary disposition rather than an *inter vivos* one relates to the proper construction of the trust document and is a special case where the document fails to create an *inter vivos* trust, but does create a trust upon the testator's death. Gifts that are conditional upon the death of the settlor tend to exhibit certain qualities that lead to a finding that the disposition is testamentary in nature:

(a) the settlor retains a power of revocation (this goes to the question of the settlor's intention to create a trust);

(b) the property may not be properly identified until death (thus, the second certainty is questioned); and

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(c) the settlor will often retain undue power over the appointment of trustees and the identification of beneficiaries.

The test commonly used by the courts to determine whether a disposition is testamentary or not is that as set out in *Cock* v. *Cooke* (1886), L.R. 1 P.&D. at 241. A document is testamentary "if the person executing it intends that it shall not take effect until after his death, and it is dependant upon his death for its vigour and effect…".

This does not mean that *inter vivos* dispositions that depend on the death of the settlor will be automatically construed as testamentary in nature. Two British Columbia cases illustrate this point.

Wonnacott v. *Loewen* (1990), 37 E.T.R. 244 (B.C.C.A.) dealt with a series of documents that, in effect, set up an *inter vivos* disposition of property. While the arrangement was not a trust *per se*, the transaction as a whole established an *inter vivos* disposition where the donor of the property maintained a high level of control, including a right to revoke. The court in *Wonnacott* held that the disposition was not testamentary. Its decision was based on the nature of the instrument of the transactions alone and not the conduct of the donor. The court cited Frank Ford J.A. in *Anderson* v. *Patton*, [1948] 1 W.W.R. 461 (Alta. C.A.) at 463:

> "If the document is not intended to have any operation until the settlor's death it is testamentary. If the document is intended to have and does have the effect of transferring the property or of setting up a trust thereof *in praesenti*, though to be performed after the settlor's death, it is not testamentary. The reservation of a power of revocation is not inconsistent with the creation of a valid trust and does not have the effect of making the document creating it testamentary."

The facts in *Wonnacott* are important because they differentiate the transaction from a purely testamentary one. The donor had arranged the transaction so that the property in question would pass to the donee, with whom he lived, upon his death. The donor's right to revocation was contingent upon certain events. First, if the donor and donee separated for more than 30 days and second, upon payment of $60,000 to the donee. Seaton, J.A. held at page 252 that when the series of documents were looked at as a whole, they constituted an *inter vivos* disposition that had vigour and effect from its inception. "Mrs. Loewen obtained an interest in the property immediately. She had the right to live there and, as would be the case if she were a joint tenant, the property would be hers on the death of Mr. Wonnacott. She has an interest that had real value, no matter what happened."

In *Hecht* v. *Hecht Estate* (1991), 42 E.T.R. 295 (B.C.S.C.), (sub. nom. *Hecht* v. *Reid*), the gift of promissory notes and a gift of land, redeemable only upon the settlor's death, were found to be valid *inter vivos* gifts. The gifts were perfected before Mr. Hecht's death despite the fact that they were not to be transferred to the beneficiaries until 60 days after he died. Although the settlor retained a power of revocation, he was not a trustee. The key finding in *Hecht*, as in *Wonnacott*, is that the *inter vivos* dispositions created ascertainable rights from the outset.

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Although the benefits of the dispositions were only realized after the settlor's (or donor's) death, the rights were created before death.

5. Conclusion

How a court will regard a purported *inter vivos* trust will depend on a number of factors. Is the document creating the trust proper? Does it satisfy the three certainties? What is the nature of the involvement of the settlor in the administration of the trust? Does the trustee properly deal with the assets in trust, or does he or she treat them as his or her own? Finally, can the trust be properly understood as an *inter vivos* disposition as opposed to a testamentary one?

In practice, a trust must always be founded on a sound document that clearly identifies the three certainties. Where the beneficial enjoyment of the property in a trust is delayed until after the settlor's death, but the intention is to create an *inter vivos* trust, care must be taken to ensure that the document creating the trust exhibits a clear intention to create a trust and gives certain people a discernible right in defined property. As cases like *Wonnacott* and *Hecht* show, the settlor can still retain a significant element of control over the trust without invalidating it. In both of these cases, the trust (or gift) was founded on a sound document. Balancing the wishes of the settlor with the technical requirements of a trust is the challenge facing practitioners. As a matter of sound practice, it also makes sense to advise clients of the need to act in a manner consistent with a trust. *Antflick* and *Circle P Paving* both illustrate how abusing a trust, regardless of whether it is well established, can result in a court regarding it as a sham.

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