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# 21-YEAR TAX ISSUES AND THE NON-SPECIALIST ADVISOR — PART 3[1]

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Part 1 of this Series reviewed what the 21-year deemed disposition rules are and introduced three approaches to planning that appear to be most commonly used to manage the effects of the 21-year deemed disposition rules: Do Nothing, the *Simple* Roll-Out, and Vesting Indefeasibly. Part 1 of the Series also reviewed the Do Nothing approach. Part 2 of the Series reviewed the *Simple* Roll-Out approach in detail and, in this third instalment of the Series, the Vesting Indefeasibly approach will be discussed.

## Vesting Indefeasibly Approach

Unfortunately, sometimes either a trust won't be able to utilize *Simple* Roll-Out planning to distribute its appreciated property to its beneficiaries on a tax-deferred basis prior to its 21st anniversary, or the trustees may determine that it is not desirable to distribute trust property to the beneficiaries for non-tax reasons.

In these types of situations, the Vesting Indefeasibly approach can be extremely helpful.[2]

### Paragraph (*g*) Trusts

To understand this exception to the 21-year deemed disposition rules it is important to review the meaning of the term "trust" in subsection 108(1). In particular, one needs to look to the mid-amble just before paragraph (*f*) of the definition, which provides an exception to the 21-year deemed disposition rules if a trust satisfies the tests in either paragraph (*f*) or (*g*) of the trust definition.

Paragraph (*f*) provides an exception for "unit trusts" and will not be discussed further.

A trust will be a paragraph (*g*) trust if it is a trust, all of the interests in which have vested indefeasibly at a particular time unless certain exceptions to this relieving rule are applicable. The exceptions that are generally of most common concern apply to Canadian-resident trusts where the interests of non-resident beneficiaries in the trust exceed 20% of the FMV of all of the interests in the trust, to trusts that are subject to any life interests,[3] and to trusts that are terminable with reference to a period of time, including a person's death.

The rationale for the exception allowing the Vesting Indefeasibly approach appears to be that because the interest the beneficiary has in such a trust does not cease on death, or by reference to a period of time, including a person's death, the interest will be subject to the ordinary deemed disposition rules in subsection 70(5).

### What Does "Vest Indefeasibly" Mean?

From a property law perspective, the concept of "vest indefeasibly" essentially means that the beneficiary who is entitled to the vested interest is in existence and ascertained

[1] Unless otherwise noted, defined terms in this article have the meaning designated in the first instalment of the Series.

[2] See the "Do Nothing" approach discussion in Part 2 of the Series.

[3] In this regard life interests means "an alter ego trust, a joint spousal or common-law partner trust, a post-1971 spousal or common-law partner trust or a trust to which paragraph 104(4)(*a*.4) applies."

and the beneficiary's interest in the trust cannot be subject to any condition or limitation.[4] A useful case to review about the meaning of the term vested indefeasibly is *The Queen v. Boger Estate*.[5]

An interest that has vested indefeasibly has been described as "a gift without strings".[6] However, this isn't necessarily true since, in many cases, the trustees will be entitled to remain in possession of the trust property associated with the vested interest until the trustees make a determination to make distributions of the trust property, which seems to be a fairly significant string.

In most Canadian provinces, pursuant to the rule arising from the case of *Saunders v. Vautier*,[7] as modified by statute,[8] even where the trustees are intended to remain in possession of the trust property, if all of the beneficiaries with vested interests are *sui juris* (i.e., beneficiaries under no legal incapacity) and act together, they might be able to force the hand of the trustees to distribute the trust property.[9]

## How Do Interests in a Trust Vest Indefeasibly?[10]

In a typical discretionary family trust situation, causing trust interests to vest indefeasibly can be accomplished[11] by the trustees passing a series of resolutions that will ensure that the class of beneficiaries has closed; confirms that no further additions to the trust property are possible; and identifies the beneficiaries and their respective interests in the trust as well as the trust property that is to be applied for the benefit of each particular beneficiary.

In addition to the foregoing steps, the resolutions should make it clear that the vested interests in the trust are to be held by the beneficiaries unconditionally and that the interests must not be subject to any conditions precedent, conditions subsequent, or determinable limitations.[12]

It will be important to analyze the trust deed to determine whether there may be impediments to taking steps to cause the interests to vest indefeasibly. Although it has been suggested that it would be ideal for the trust document to contain a clause allowing the trustees to convert a discretionary interest to a nondiscretionary interest specifically assigned or fixed to a beneficiary on a chosen date, there does not appear to be any particular authority to suggest that such a clause is a requirement to cause interests to vest indefeasibly.

## Risks and Issues Associated with the Vesting Indefeasibly Approach

Some risks and issues associated with the Vesting Indefeasibly approach are described below:

- As is the case with all trustee decisions, the trustees will need to properly address their fiduciary obligations. This is particularly so in a situation where certain beneficiaries may be expressly excluded from benefitting from the trust as a result of the process.
- Even if the Vesting Indefeasibly approach doesn't create legal issues that could give rise to a claim by the beneficiaries against the trustees, the process could create family discord if family members who might otherwise have been beneficiaries of the trust are excluded.
- The beneficiaries may act together to force the trustees to distribute the property of the trust pursuant to the rule in *Saunders v. Vautier*.[13]

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[4] For more on the meaning of the vested indefeasibly concept see M. Elena Hoffstein and Corina S. Weigl, "Overview of the Twenty One Year Rule — A Trust Lawyer's Perspective", in 2014 Ontario Tax Conference (Toronto: Canadian Tax Foundation, 2014), 7:1-62. See also, Catherine Brown, "Vested Indefeasibly: Its Importance for Tax Purposes", Personal Tax Planning feature (2006) 54:4 Canadian Tax Journal 968-991. In addition, for the CRA's views, see Interpretation Bulletin IT-449R, "Meaning of Vested Indefeasibly", dated September 25, 1987 (cancelled).

[5] 1993 DTC 5276 (FCA).

[6] Catherine Brown, *supra* note 4 at 973.

[7] (1841), 49 ER 282 (Rolls Ct.); aff'd. (1841), 41 ER 482 (Ch. D.).

[8] For example, in Ontario see *Variation of Trusts Act*, RSO 1990, c. V.1.

[9] This principle is often referred to as the rule in *Saunders v. Vautier*. The rule in *Saunders v. Vautier* has been abolished in Manitoba and Alberta. There may be a risk that the rule in *Saunders v. Vautier* could be extended to permit a single beneficiary with an indefeasibly vested interest in a trust to force an immediate distribution of his/her share of the property of a trust even when other beneficiaries with indefeasibly vested interests object to the distribution (for example, see *Re Campeau Family Trust* (1984), 4 D.L.R. (4th) 667, 44 O.R. (2d) 549, 16 E. T.R. 97 (H.C.J.), applying principles identified in *re: Marshall*, [1914] 1 Ch. 192, [1911-13]All E.R. Rep. 671 (C.A.)). However, many elements of the *Campeau Family Trust* decision, including its purported extension of the rule in *Saunders v. Vautier* have been the subject of critical review (for example, see David M. Paciocco and Vern Krishna, "Re Campeau Family Trust: Two Wrongs Make a Right" (1985) 7:1 Estates and Trusts Quarterly 65-82).

[10] Many of the items discussed in this section are discussed in the articles referred to in note 4, *supra*.

[11] The discussion in this section is not intended to be comprehensive of all of the ways that can result in interests in a trust becoming vested indefeasibly.

[12] As mentioned previously, there is no requirement for a beneficiary with a vested interest in a trust to have the right to compel the trustees to distribute the trust property associated with the vested interest.

[13] *Supra*, note 9.

- Even though the beneficiary does not own the underlying trust property, because a vested trust interest is a fixed and determinable interest in property, it will become an asset that is fully exposed to creditors of the vested beneficiary.
- The interest will be an asset that is considered to be owned by the beneficiary and subject to tax on death. In addition, double taxation could arise under certain circumstances.[14]

[14] For example, see Jason M. Stephan, "Understanding and Dealing With the 21-Year Deemed Disposition Rules Affecting Certain Trusts", *2008 Prairie Provinces Tax Conference*, (Toronto: Canadian Tax Foundation, 2008), 14:1-35 at page 25.

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