

## Hull on Estates Podcast #51 **The Trustee's Power to Encroach on Capital**

Posted on March 20<sup>th</sup>, 2007 by [Hull & Hull LLP](#)

Suzana Popovic-Montag: Hi and welcome to Hull on Estates. You're listening to Episode #51 of our podcast on Tuesday, March 20<sup>th</sup>, 2007.

*Welcome to Hull on Estates, a series of podcasts for the Canadian legal community dealing with issues and insights surrounding estate planning in Canada. Hosted by the lawyers of Hull & Hull, the podcast will touch on some key considerations when planning estates and Wills. Now, here are today's hosts.*

Ian Hull: Hi Suzana.

Suzana Popovic-Montag: Hi there Ian, how are you?

Ian Hull: Just great.

Suzana Popovic-Montag: That's good.

Ian Hull: I was at a conference about a month ago, and someone came up to me and asked me a question that I thought, boy, you know, this question comes up more and more these days as estate planning gets more complex and more trusts are being used, both *inter vivos* and testamentary. And the person came up to me and asked me, they had a client of theirs, who was in their eighties and he was in good health, a strong person but he was the beneficiary of a trust, which held a house. And he lived in the house. The provisions of the Will set out the sort of standard that he would, all he really had to pay for was the insurance and heat and light and that sort of thing. But his income was declining, and it's a big house and it was starting to eat away at his capital. And so the question arose as to whether or not he could encroach on the capital. And this whole question of when you encroach on capital is always a difficult one, and I thought it would be worthwhile talking about today.

Suzana Popovic-Montag: Well that's a great suggestion, Ian because I know, certainly from my own experience, my own practice, these kinds of questions do arise quite often, surprisingly so.

Ian Hull: And one of the things that, one of the early, well early, one of the cases that I always go back to is the case of *Fox vs Fox* which was a Court of Appeal decision, where the court really struggled with this whole question of the power to encroach. And in that case, the trustee encroached the whole of the estate for the benefit of the gift over beneficiaries and that would be her grandchildren, to the exclusion of her son. And the court in that case wasn't very happy with the behaviour of the trustee and essentially took the position that there was *malafides* or there was improper intent at the time. But let's, before we get into sort of the case law, just sort of talk from first principles. And really

what kind of advice we want to give our clients in situations where there is a power to encroach in the Will, it is a trust or a Will or a trust, there is a power to encroach, what's the first step we should go to?

Suzana Popovic-Montag: Well I think the first step, Ian, really is that legal advice should be sought. And I know it's not a common thing that trustees will necessarily do, but just the suggestion as you made with the **Fox** decision, perhaps that beneficiary or that trustee didn't understand what her rights and obligations were. So if you have the benefit of having someone review the terms of the Will, which are key, the trust will have either the right to encroach on capital or not, and that is a key provision that the trustee needs to know. And then the exercise of discretion, if it's going to be exercised, knowing the parameters of that with the assistance of legal counsel, is really quite helpful.

Ian Hull: What's this old rule that we have to sort of start with when you have to consider whether or not the Will allows the trustee to encroach upon the capital?

Suzana Popovic-Montag: Well I think, Ian, you're referring to the Armchair rule of construction.

Ian Hull: Right.

Suzana Popovic-Montag: And that's the rule that when you're trying to interpret the provisions of a Will, or the meaning of a Will, you sit yourself in the armchair of the testator, so to speak, to determine what were the circumstances, what was the situation at the time that the Will was created, to help you evoke from that the testator's intent.

Ian Hull: The other principle that we have to keep in mind as a trustee, and when giving advice to trustees, is the Evenhand principle as well. Once we've got over the hurdle of whether or not we can truly sit in the armchair, look at the surrounding circumstances and consider the character and occupation of the testator and those kinds of things. Once the Armchair rule has been canvassed and we are in a position to really properly assess the intention of the testator, the next principle concept really is the Evenhand principle.

Suzana Popovic-Montag: And that principle refers to the balancing, so to speak, between the interests of the income beneficiaries under a trust and the capital beneficiaries. And the idea being that when you make your decision to encroach on capital, you're keeping in mind the effect it'll have on the income and the capital beneficiaries at the same time.

Ian Hull: And that's such a terrible burden on many executors because it's almost impossible to guess right. And one great article of Maurice Cullity, as he then was, wrote "Trustee Duties, Powers, and the Exercise of Discretionary Powers" and it was for the Special Lectures in the Law Society of Upper Canada in 1980. He comes right out in that article and he says that "*there's a danger that the trustee's decision, when considering the two balanced Evenhand approach, will seem reasonable when it is made, but will acquire a very different appearance when it's judged in hindsight.*"

Suzana Popovic-Montag: And it's interesting you see that article, you said was 1980. That means it's at least twenty-seven years old, and yet these principles, the fundamental principles in trust law, still hold true.

Ian Hull: Well that's right, and I think a large part of that is because of the good words and the good guidance that we all received in the decision. Really the leading case in this area, that is **Gisborne vs Gisborne**, and that's an 1877 decision, where the UK House of Lords looked at the whole question of the scope and the extent of the power to encroach.

Suzana Popovic-Montag: And it's interesting because in that case. Ian, although it's not what we'd strictly speaking call a capital encroachment case, it does look at the circumstances and whether or not a beneficiary's resources. The resources that that person has on his or her own is something that we can validly take into account when deciding whether or not to exercise our discretion.

Ian Hull: In that case, and we're going to definitely get into this whole question of resources because when that conference question came to me, that was the big issue. The executors felt that the elderly gentleman had lots of resources and therefore they were allowed to essentially not provide for the encroachment. But before we get to the resources, one of the things that **Gisborne** taught us and the **Fox** decision highlights that as well, is this whole idea of *malafides*. And what is the court getting at with that?

Suzana Popovic-Montag: Well the idea there, Ian, is that if you're going to be exercising discretion, you can't do so capriciously or based on extraneous circumstances or considerations. You've got to have a very, I guess, *malafides* directly translated, you've got to have good intentions when you exercise your discretion.

Ian Hull: And an example of that was in the **Fox** case, where the court felt that the trustee was motivated by taking the capital encroachment and essentially taking it away from the income beneficiary because she was worried that her son was going to marry out of the faith. And that was seen as a *malafides*, in that sense of motivation. Alright, so beyond the **Fox** decision though, and you've raised an important point. And that, I guess, is another example of what could be seen as *malafides* and that is, is if making the decision as a trustee, you look at the financial resources of the beneficiary. And you talked about earlier that it may be that you're not allowed to or may be that you are allowed to. What are the courts saying on this issue?

Suzana Popovic-Montag: Well the first thing they're referring people to are the actual provisions of the Will and the trust itself. So if the testator or the trustee has directed that to be a valid consideration, then it certainly can be taken into account. But I think generally speaking if there isn't a specific provision to that effect, then the courts are saying, we don't think that that's necessarily going to be a valid consideration.

Ian Hull: And I think, just in terms of getting into the real meat of the case law in this, there's an article that I wrote in the *Estates, Trusts and Pensions Journal, Volume 24* in 2004. And I dealt with this particular question of power of encroachment, and in

particular, whether or not the personal resources of the beneficiary matter. And that's just helpful, I think, for those who want to go and find the case law. But in that article, I reviewed sort of five or six of the leading cases in this area on the question of whether or not you're entitled to look at the personal resources of the beneficiary. And without getting into great detail on the case law, it's in that article and I think at least a starting point, certainly for a review of this. So, in summary then, in terms of the power to encroach, we have to find it in the Will or the trust document. And that's crucial, if the document doesn't allow for it, then that's almost a non-starter. But presuming there is some language, and the typical language that we will see in a lot of these cases is, I mean, it's used in different ways. But, for example, it might say that to my said trustees to pay to my wife, for the benefit of my said wife, such part or parts of the whole of the capital of the residue of my estate as in their uncontrolled discretion, my said trustees consider advisable. That kind of language, you want to look for that, number one, in the context of whether or not there is a power to encroach. What's our next step?

Suzana Popovic-Montag: And the next step then, Ian, is to consider why it is that you're exercising you're discretion, and that it won't somehow be viewed as a *malafides* consideration.

Ian Hull: And keeping in mind at all times the Armchair rule that insists that we sort of sit in the chair of the testator to assess intention. And then finally, as you say, when it comes right down to it, the *Hinton vs Canada Permanent Trust* is a leading case in this area. And it really stands for the proposition that unless the testator specifically requires the trustee to consider the financial resources of the beneficiary, the trustee may in fact ignore such factors in exercising their discretion.

Suzana Popovic-Montag: And then just to wrap up, Ian, I think that in terms of the momentum of the case law, we want to just be aware of the fact that although we talk about *malafides* and saying that that can't be something that's considered by a trustee, or they can't exercise their discretion improperly, the courts are going one step beyond that and sometimes referring to even extraneous purposes or extraneous considerations which might leave some room for interpretation as to whether or not a trustee is taking something improperly into account.

Ian Hull: And so, do you have an example of that, what you mean by the extraneous considerations that the court might be looking at?

Suzana Popovic-Montag: Well if a trustee is characterizing something in a way so as to avoid it, being blatantly something that would be under the category of *malafides*, like if they're looking at religious considerations.

Ian Hull: Great Suzana, thank you very much.

Suzana Popovic-Montag: Thanks Ian, bye now.

*This has been Hull on Estates with the lawyers of Hull & Hull. The podcast you have been listening to has been provided as an information service. It is a summary of current legal issues in estates and estate planning. It is not legal advice and you are reminded to always talk with a legal professional regarding your specific circumstances.*

*To listen to other podcasts, or to leave a question or comment, please visit our website at [www.hullandhull.com](http://www.hullandhull.com).*

*Our theme music is Upper Structure by DJ AKid and is courtesy of the Podsafe Music Network.*

/mem

X:\Podwise\HULL & HULL FILES\PDF Podcasts\hoe#51.doc