

**HULL & HULL
ESTATE, TRUST AND CAPACITY LAW BREAKFAST
SERIES**

PREPARING ESTATE ACCOUNTS – AN OVERVIEW

**Tuesday, September 13, 2005
Ontario Bar Association**

Speakers:

**Ian M. Hull
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Hull & Hull
Estate, Trust and Capacity Law Breakfast Series

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PASSING OF ACCOUNTS – AN OVERVIEW

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Passing Of Accounts – An Overview

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1. INTRODUCTION

Litigation involving fiduciary accounting is often contentious, time-consuming and costly. With the introduction of the amendments to the *Trustee Act* and the *Substitute Decisions Act*, S.O. 1992 as amended, the focus on fiduciary accounting has changed fairly dramatically. While the obligations and responsibilities have not significantly changed, there has been a change in the nature of the litigation and the volume of complaints, problems and litigation arising from these circumstances, has increased.

ATTORNEY'S ACCOUNTS

There is clear statutory and common law authority for the proposition that a fiduciary or attorney has a duty to account¹.

Section 42 of the *Substitute Decisions Act* provides as follows:

(1) **Passing of Accounts.** – The court may, on application, order that all or a specified part of the accounts of an attorney or guardian of property be passed.

(2) **Attorney's Accounts.** – An attorney, the grantor or any of the persons listed in subsection (4) may apply to pass the attorney's accounts.

(3) **Guardian's Accounts** – A guardian of property, the incapable person or any of the persons listed in subsection (4) may apply to pass the accounts of the guardian of property.

(4) **Others entitled to apply** – The following persons may also apply:

- (1) The grantor's or incapable person's guardian of the person or attorney for personal care.
- (2) A dependant of the grantor or incapable person
- (3) The Public Guardian and Trustee.
- (4) The Children's Lawyer.
- (5) A judgment creditor of the grantor or incapable person.
- (6) Any other person, with leave of the court.

(5) **P.G.T. a party** – If the public Guardian and Trustee is the applicant or the respondent, the court shall grant the application, unless it is satisfied that the application is frivolous or vexatious.

(6) **Filing of accounts.** – The accounts shall be filed in the court office and the procedure in the passing of accounts is the same and has the same effect as in the passing of executors' and administrators' accounts.

(7) **Powers of court.** – In an application for the passing of an attorney's accounts the court may, on motion or on its own initiative,

- (a) direct the Public Guardian and Trustee to bring an application for guardianship of property;

¹ See *Re Taerk*, [1957] O.R. 482 (C.A.), also see *Re Warsh* unreported decision of Sheard J., August 26, 1994, O.J. No. 3234/93 and Rule 74 of the *Rules of Civil Procedure*

- (b) suspend the power of attorney pending the determination of the application;
- (c) appoint the Public Guardian and Trustee or another person to act as guardian of property pending the determination of the application;
- (d) order an assessment of the grantor of the power of attorney under section 79 to determine his or her capacity; or
- (e) order that the power of attorney be terminated.

(8) **Same.** - In an application for the passing of the accounts of a guardian of property the court may, on motion or on its own initiative,

- (a) adjust the guardian's compensation in accordance with the value of the services performed;
- (b) suspend the guardianship pending the determination of the application;
- (c) appoint the Public Guardian and Trustee or another person to act as guardian of property pending the determination of the application; or
- (d) order that the guardianship be terminated.

This provision is further expanded by section 49(3) of the *Estates Act*² which provides as follows:

The judge, on passing any accounts under this section, has power to inquire into any complaint or claim by any person interested in the taking of the accounts of misconduct, neglect, or default on the part of the executor, administrator or trustee occasioning financial loss to the estate or trust fund and the judge, on proof of such claim, may order the executor, administrator or trustee, to pay such sum by way of damages or otherwise as the judge considers proper and just to the estate or trust fund, by any order made under this subsection is subject to appeal.

As to the common law authority, the Ontario Court of Appeal *Re: Taerk*³ stated:

It is plain to me that after the amendment to the *Surrogate Courts Act*, as now found in s.772(3), *supra*, a Judge on passing the accounts of an executor, administrator or such a trustee, has jurisdiction to enter into and make full inquiry and accounting of and concerning two classes of property, namely: (the numbering is mine) (1) The property which the deceased was possessed of at the time of his death. (2) The property which the deceased was entitled to at the

² R.S.O. [1990, c.E.2].

³ [1975] O.R. 482 (C.A.).

time of his death. For the purpose of making such inquiry and accounting, a Judge is expressly empowered to "decide all disputed matters arising in such accounting subject to appeal". The scope of the inquiry and accounting which may be lawfully made by a Judge of the Surrogate Court is not limited to the property in possession of the deceased at the time of this death. It extends to and includes property which the deceased was entitled to at that time, and the Judge may decide all disputed matters arising in such accounting in respect of the title to such property. Thus, in my opinion, it was within the scope of s. 72(3) and the jurisdiction of a Judge of the Surrogate Court acting thereunder to enter into and make full inquiry concerning the rights of the deceased at the time of his death to the money, bonds and coupons owned by him in his lifetime and which during his lifetime had passed into the possession of the defendants, or the defendant Alexander J. Turk, as the case might be. If, upon such an inquiry, a Judge decided that the deceased was entitled to such money, bonds or coupons or any part of them, he had power under the subsection to compel the executors to make an accounting thereof.

II. THE FORM OF THE ACCOUNTS

Rule 74.17 of the Rules of Civil Procedure provides as follows:

(1) Estate trustees shall keep accurate records of the assets and transactions in the estate and accounts filed with the Court shall include,

(a) on a first passing of accounts, a statement of the assets at the date of death, cross-referenced to entries in the accounts that show the disposition or partial disposition of the assets;

(b) on any subsequent passing of accounts, a statement of the assets on the date the accounts for the period were opened, cross-referenced to entries in the accounts that show the disposition or partial disposition of the assets, and

a statement of the investments if any, on the date the accounts for the period that they were opened;

(c) an account of all money received, but excluding investment transactions recorded under clause (e);

(d) an account of all money disbursed, including payments for trustee's compensation and payments made under a court order, but excluding investment transactions recorded under clause (e);

(e) where the estate trustee has made investments, an account setting out,

(i) all money paid out to purchase investments,

(ii) all money received by way of repayments or realization on the investments in whole or in part, and

(iii) the balance of all the investments in the estate at the closing date of the accounts;

(f) a statement of all the assets in the estate that are unrealized at the closing date of the accounts;

(g) a statement of all money and investments in the estate at the closing date of the accounts;

(h) a statement of all the liabilities of the estate, contingent or otherwise, at the closing date of the accounts;

(i) a statement of the compensation claimed by the estate trustee and, where the statement of compensation includes a management fee based on the value of the assets of the estate, a statement setting out the method of determining the value of the assets; and

(j) such other statements and information as the Court requires.

(2) The accounts required by clauses (1) (c), (d) and (e) shall show the balance forward for each account

(3) Where a will or trust deals separately with capital and income, the accounts shall be divided to show separately

receipts and disbursements in respect of capital and income.

It can be seen therefore that any accounting by Executors and Trustees has both a broad and a narrow aspect.

In the broad sense, it is an obligation whereby the Executor or the Trustee furnishes information to interested parties on an ongoing basis concerning the administration of the Estate or Trust.

In the narrow sense, the Trustee's accounting relates to the accounts prepared by her at the close of her administration (or some appropriate intermediate stage) so as to reflect the transactions that have occurred, with a view to discharging the trustee from liability for his stewardship.

Usually a Trustee informs the beneficiaries of the results of his administration on an interim annual basis. This statement usually sets out the income or revenue received, the expenses incurred and the net result of investments, together with a list of assets.

Interim reporting statements vary widely in the manner of their presentation and the detail of the information to a greater or lesser degree and are designed to demonstrate the performance of the trust and frequently resemble the form of corporate financial statements.

However helpful these statements may be in assessing the skill of the Estate Trustee in administering or managing the estate or trust that format is not to be confused with the simple accounting of past transactions required by Rule 74.17 which is fundamentally different in purpose.

For example, the simple format contemplated by the Rule is strictly a record of each transaction which has in fact occurred. It does not contemplate usual business accounting concepts such as depreciation, accounts receivable, accounts payable, provision for doubtful accounts or reserves which are concepts applicable to performance or business accounting.

The purpose of the type of accounting contemplated by the Rule is to record all transactions in the estate with a view to extinguishing trustee's obligation to further account in the administration of the estate.

Once the accounts have been passed, the executor or trustee is relieved of any further accounting for the period except for items arising as a result of fraud or mistake.

By and large the format of the accounts prepared by Executors and Trustees for passing is relatively well established and well known to those familiar with the preparation and passing of accounts.

In general terms, the accounts should provide all essential information to all persons interested or entitled to an accounting in the estate or trust in a manner that is capable of being understood by a person of average intelligence, literate in English, and familiar with basic financial terms, who has read it with care and attention. Accordingly, Executors and Trustees preparing their accounts should be careful to avoid technical terms such as "debit" and "credit" which are generally not known to persons who are not familiar with bookkeeping and accounting practices.

One of the main problems encountered by Executors and Trustees in answering requests for information or explanations from beneficiaries is that the beneficiaries frequently do not read the accounts with the required care and attention which is essential if the accounts are to be understood.

On the cover of the accounts, a short statement of the purpose of the accounting such as "The Trustees present these accounts for the approval of the Judge and to acquaint interested parties with the administration of the Estate and its proposed distribution" might well be added.

Furthermore, a statement to the effect that the accounts should be carefully considered and a named person should be specified as being available to answer questions arising out of the accounts.

It is also suggested that the date of the passing of the accounts should be inserted on the front page.

Next, there should be included in the accounts an index disclosing the page numbers of the summary, the assets comprising the estate at the beginning and end of the accounting period, income, capital and investment transactions and a statement of the compensation claimed by the Executors and Trustees.

Each category set out in the summary should refer to the schedule in the accounts supporting that category and which will provide the details on which the summary is based.

After the summary of the accounts, the next item is the inventory of the assets as at the date of death or creation of the trust or at the beginning of any subsequent accounting period. These items should be detailed and should not simply refer to a total amount or refer to an inventory filed, either on another passing or in another location.

While the assets in the inventory are recorded and maintained in the accounts at book value, i.e. the amount at which the Executor or Trustee obtained the assets, it is suggested that because these values are commonly misunderstood by persons considering the accounts as being a representation of actual values, in addition to the book value, the current market values should also be indicated in the inventory.

The next schedule reflects the assets of the estate or trust as at the date of the preparation of the accounts and the comments relating to the insertion of current market values pertain to this schedule.

One comment, however, is that where income or revenue from a number of securities is being accounted for over a long period of time a statement of the dividends from each security segregated from the other receipts will be more readily understandable and easier to check for completeness than a chronological listing of all dividends received.

The next item to be dealt with is a schedule of the investment account transactions setting out the sale or other disposition of securities during the accounting period. These transactions are shown as a separate item in a combined schedule indicating the transaction, date and explanation.

It is my suggestion that the investment account should indicate gains and losses from the sale or purchases of securities as a separate schedule.

The next item, being the statement of compensation - While no hard and fast rule can be held to prevail, generally speaking 2-1/2% is allowed on capital and revenue receipts and disbursements and a management fee of 2/5 of 1% per annum on the average value of the estate is also allowed.

If special services or duties are require to be performed by the Executors and Trustees in the administration of the estate or trust an additional special fee may be allowed.

III. COMPLAINTS AND CLAIMS AGAINST TRUSTEES ON AN ACCOUNTING

Rules 74.18(7) and (12) provides as follows:

Notice of Objection to Accounts - 74.18(7)

Subject to subrule (8), which applies only to The Children's Lawyer and The Public Guardian and Trustee a person who is served with documents under subrule (4) or (5) and who wishes to object to the accounts shall do so by serving on the estate trustee and filing with proof of service a notice of objection to accounts (Form 74.45), at least 20 days before the hearing date of the application.

Hearing - 74.18(12)

No objection shall be raised at the hearing that was not raised in a notice of objection to accounts, unless the court orders otherwise.

Most claims or objections will arise out of a claim of alleged negligence of the executor or trustee by a beneficiary by reason of the executor or trustee not exercising the proper standard of care pertinent to her office.

As to just what standard of care is applicable to the office of executor or trustee is extremely difficult to determine.

Theoretically, it would seem that the law requires of a trustee no higher degree of skill to be brought to the office of executor or trustee than that of a man or woman of ordinary prudence in the management of his or her own affairs.

This implies that the law does not differentiate between the degree of skill required to be exercised by, let say, a trust company and a heavy equipment

operator. We know that from a practical standpoint such a view is not usually taken by judges on a passing of accounts and the rule might well be restated that while the law may not differentiate between the degree of skill required to be exercised by different executors and trustees, the likelihood of being excused a breach of trust under section 35 of the Trustee Act of Ontario diminishes as the sophistication of the executor or trustee increases.

(a) Negligence⁴

Generally speaking, most claims or objections arise out of what is perceived by beneficiaries to be negligence or failure on the part of the executor or trustee to maintain a proper standard of care and skill in her office and the most common complaints arise out of the following situations:

- (i) Investments by the executor or trustee which are not authorized by the will or by the law;
- (ii) The failure to provide a proper mix of investments so as to balance competing interests such as life interests as opposed to remainder interests;
- (iii) The negligent or improper investment by the executor or trustee in investments of a speculative nature;
- (iv) An executor or trustee can be held liable for not maintaining the value of assets such as a residence by effecting proper repairs and would be liable for such neglect;
- (v) Executors or Trustees must be extremely careful to make sure that all proper considerations are taken into account in making elections under the Income Tax Act so as to avoid any criticism by the beneficiaries;

⁴ For a comprehensive discussion on the personal liability of trustees see: Maurice C. Cullity, Q.C., "Personal Liability of Trustees and Rights of Indemnification", 16 Estates and Trusts Journal 115.

(vi) Care must be taken by an executor or trustee to ensure that prompt filings of returns are made and that penalties and interest payable on late filings are not incurred;

(vii) While trustees are seldom culpable for what are perceived by beneficiaries to be unnecessary delays, care must be taken to ensure that damages are not in fact incurred by the beneficiaries by reason of delays caused by inattention.

(b) Surcharging of Accounts

(i) Definition - a surcharge alleges an omission for which there ought to be credit;

(ii) Examples - the most frequent surcharges relate to under-evaluation of assets, assets not accounted for, non-disclosure of an asset and in some cases the incorrect recording of an entry.

(c) Falsification of Accounts

(i) Definition - a falsification alleges an item on the debit side of the account to be either wholly false or in some part erroneous;

(ii) Examples - a claim against the estate which does not exist or is not realistic or a payment by the estate of an account which is excessive and in some cases the incorrect recording of an entry.

(d) Incorrect Recording of Entries

While the incorrect recording of an entry is seldom the subject matter of damage, it is sometimes difficult to know precisely into which account an entry should be recorded.

An example of an entry in the wrong account which could be the subject matter of some damage to a beneficiary would be the payment of a dividend from a company to its shareholders from accumulated surplus. The question as to whether the dividend is paid on account of income or capital is a nice one.

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RECEIPTS AND DISBURSEMENTS IN ESTATE ACCOUNTS

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Receipts and Disbursements in Estate Accounts

A. Sean Graham, Hull & Hull

The receipts and disbursements portions of estate accounts reflect the active administration of the estate, except for investment steps, which are recorded in the investment account. Put simply, all monies upon first entering into the active administration of the estate trustees, whether by placement into an estate bank account or otherwise, are receipts, and all funds leaving the administration of the estate trustees are disbursements.

For an immediately-distributable estate, there is no need to distinguish between capital and income: one section in the accounts setting out all receipts and one setting out all disbursements is sufficient. However, where the estate is ongoing, or where trusts are established under the Will with separate income and capital beneficiaries, then the following four lists of receipts and disbursements must be included:

1. Capital Receipts;
2. Revenue Receipts;
3. Capital Disbursements; and
4. Revenue Disbursements.

Capital Receipts include:

- Monies received on the realization of original assets.
- Insurance proceeds (assuming the estate is the beneficiary).

- Death benefits.
- Refunds of monies paid by the deceased before death.
- Principal portions of mortgage payments. Note that where a mortgage payment has both principal and interest components, the two should be separated into capital (principal) and income (interest) receipts in the accounts.
- Personal property over which the estate trustees take control with values as at the date the estate trustees start to administer the property (usually the date of death or not long after).

Revenue Receipts include:

- Income received from unrealized original assets and executors' investments, usually comprised of interest, dividends, and/or rental income.

Capital Disbursements include:

- Payment of funeral expenses.
- Taxes paid on the terminal income tax return and fees, if any, incurred in preparing the terminal return.
- Payments of the estate's debts.
- Appraisal and valuation expenses incurred to determine the value of the original assets.

- Losses on the sale of original assets for the period from the time of death to the date of the sale.
- Losses on the sale of executors' investments.
- Income tax paid on capital gains.
- Solicitors' fees incurred in relation to the administration of the estate.
- Distributions of capital bequests (of any nature, including personal property) to beneficiaries.

Revenue Disbursements include:

- All payments out of income, including income tax and fees incurred in preparing the tax returns (subject to possible capital gains tax on sales of assets which are capital disbursements).
- Distributions to income beneficiaries.

All Receipt and Disbursement entries must include details as to:

- The date of the transaction.
- The Amount of money involved.
- For receipts, the payor as well as the relevant original asset or investment if the entry reflects profit or realization.
- For disbursements, the payee, or information as to the relevant original asset or investment in case of a loss.

Receipts and disbursements lists, if controversy is anticipated, can be updated regularly and ready for production to beneficiaries on an ongoing basis. Accurate records of the assets and transactions are to be maintained in any case according to the *Rules of Civil Procedure* (see rule 74.17). Quick production, even of informal lists of original assets, receipts and disbursements, allows for quick finalization of the accounts and can quickly defuse beneficiaries' complaints in many cases without leading to a formal passing. It also acts as an excellent memory device for executors to keep abreast of their administration.

COMPENSATION

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COMPENSATION

For the purposes of this talk, I have limited this discussion to issues surrounding compensation payable to Estate Trustees, and not dealt with inter-vivos trusts, Guardianships and continuing powers of attorney for property.

(i) Quantum of Compensation

The statutory authority in Ontario for Estate Trustees and Trustees claims for compensation lies in Section 61 of the *Trustee Act*¹, which reads as follows:

61. (1) A trustee, guardian or personal representative is entitled to such fair and reasonable allowance for the care, pains and trouble, and the time expended in and about the estate, as may be allowed by a judge of the Superior Court of Justice. R.S.O. 1990, c. T.23, s. 61 (1); 2000, c. 26, Sched. A, s. 15 (2).

(2) The amount of such compensation may be settled although the estate is not before the court in an action. R.S.O. 1990, c. T.23, s. 61 (2).

(3) The judge, in passing the accounts of a trustee or of a personal representative or guardian, may from time to time allow a fair and reasonable allowance for care, pains and trouble, and time expended in or about the estate. R.S.O. 1990, c. T.23, s. 61 (3).

(4) Where a barrister or solicitor is a trustee, guardian or personal representative, and has rendered necessary professional services to the estate, regard may be had in making the allowance to such circumstance, and the allowance shall be increased by such amount as may be considered fair and reasonable in respect of such services. R.S.O. 1990, c. T.23, s. 61 (4).

(5) Nothing in this section applies where the allowance is fixed by the instrument creating the trust. R.S.O. 1990, c. T.23, s. 61 (5).

Please note the exclusion in subsection 5. Clauses in wills setting out the terms of compensation to which an Estate trustee is entitled are for the most part valid and continue to be upheld in Ontario²

¹ R.S.O. 1990, c. T.23, as amended

² *Cheney v. Byrne* [2004] O.J. 2773

While this section authorizes the payment of compensation to an executor or to a trustee, and similar provisions exist in all of the common-law provinces, Section 61 does not contain any tariffs or guidelines. The question to a court simply becomes what is "fair and reasonable"

The authority for a court only to set the amount of compensation in an application to pass accounts arises out of Section 23(2) of the *Trustee Act*.

There are two general approaches with the first one being the "five factor approach" set out in the seminal case of *Re Toronto General Trusts and Central Ontario Railway Co.*³

Under this approach a court is to consider the following factors in determining what is fair and reasonable compensation:

- a) the size of the trust;
- b) the care and responsibility involved;
- c) the time occupied in performing the duties;
- d) the skill and ability shown;
- e) the success resulting from the administration of the Estate;

³ (1905) 6 O.W.R. 350 (H.C.) at page 354

The difficulty with applying the five factors test is the huge discretion remaining in the determination of what factors to apply and in what weight each of the factors is to be given.

In order to bring some consistency to the calculation of compensation, the practice of determining compensation by way of percentage of the estate developed, with the current guidelines in Ontario being:

- a) 2.5% charged on capital receipts;
- b) 2.5% charged on capital disbursements;
- c) 2.5% charged on revenue receipts;
- d) 2.5% charged on revenue disbursements; and
- e) If an estate is not immediately distributable, an annual care and management fee of $\frac{2}{5}$ th of 1% on the gross value of the estate, based on the average yearly value of the assets remaining to be distributed in the estate.

The problem with the percentage approach is the arbitrary figure it sets and the emphasis that is placed on the size of the Estate.

What then is the correct approach?

In 1990, in *Re Jeffrey*⁴, the Court decided that the audit judge should first test the compensation claims using the percentage approach and then cross-check it

⁴ (1990) 39 E.T.R. 173 (O.C.G.D.)

against the “five- factors” approach and the Court of Appeal agreed with that analysis.

In 1998 the Ontario Court of Appeal released it's judgments in a trilogy of three executor's compensation cases, *Re Laing Estate*,⁵ *Re Gordon Estate*⁶, and *Re Flaska*.⁷

In *Re Laing*, at trial, the Court placed a great deal of emphasis on the lack of time records, and found that the estate was not overly complicated. The Executor's claim was made on the basis of a percentage claim and was greatly reduced by Wright J. on the basis of the “five factor's approach”. The Court of Appeal upheld an appeal to the Divisional Court, where the original amount of compensation payable to the Estate trustee was restored, on the basis that insufficient attention had been paid to the customary percentages and Corbett J. (of the Divisional Court) stated that that the tariff guidelines apply to estates of average complexity and should only be deviated from when the estate is either unusually complex or simple. The fact that time records were not kept properly or accurately was not fatal to the percentage claim.

In *Re Flaska* the Court of Appeal rejected the contention by the Audit Judge that compensation should be calculated solely on the basis of time spent and documented and confirmed the finding of the Divisional Court which allowed a compensation figure of about 60% of the tariff rate. It is worth noting that time records were not kept.

⁵ 1998 41 O.R. (3d) 571(C.A.)

⁶ (October 20, 1998), Doc. CA C30225 (Ont. C.A.)

⁷ [1998] O.J. No. 4171

In *Re Gordon*, the Court of Appeal held that an audit judge need not refer to each of the five factors when cross-checking the percentage approach with the five factor approach.

In all of the cases, the Court of Appeal adopted the procedure in *Re Jeffrey*, that is to start from the percentage approach, and then look at the five factors.

The approach in *Re Jeffrey* and the trinity of cases continue to being followed as recently as in March, 2005, in a case called *Sworik v. Ware*⁸.

In addition to the above, a court may consider a special claim for compensation over and above that calculable as per *Re Jeffrey*. Special fees have been awarded in circumstances where litigation was successfully carried out by the Executor on behalf of the Estate⁹, where an executor managed a company, the shares of which were solely owned by the Deceased¹⁰, in bankrupt estates or estates of nominal value, where there is a lot of activity, in researching how a new area of income tax applied to an estate¹¹, and where the Estate Trustee provided the lead in selling the shares of a company owned by the deceased, and was actively involved in negotiating the sale of the shares.¹²

⁸ [2005]O.J.3404

⁹ *Re Thorburn Estate* [1945] O.W.N. 895 (Ont. H.C.)

¹⁰ *Re Bellomo Estate* (1989) 36 E.T.R. 123 (Ont. Dist. Ct.)

¹¹ *Re Jones* (1973) 1 E.T.R. 88 (Ont. Surr. Ct.)

¹² *Re Kilgore Estate* (April 25, 1984), Doc. 25014/49 (Ont. Surr. Ct.).

It is worth noting as well that there are some types of transactions and certain types of assets where the amount of compensation paid to an Estate Trustee for administering them is reduced or not paid at all. Examples of this are as follows:

- (i) Items distributed in specie may attract a lesser rate of compensation depending on the complexity of it's management and transfer.
- (ii) Compensation is generally not paid on fees to have returns prepared unless special professional advice is required.
- (iii) No compensation is payable on book entries such as a transfer from an estate to an ongoing trust, or on a payment from an Executor to himself, such as the payment of legal fees.
- (iv) An Estate Trustee is usually responsible for the costs of preparing Estate accounts and for the preparation of income tax returns, and his/her compensation is usually reduced by commissions and investment advice paid to outside advisors such as stockbrokers.

There are also some circumstances where the mal-administration of the Estate by an Estate Trustee will reduce the amount of compensation owing to the Estate Trustee, or in some cases actually result in monies being refunded by the Estate Trustee to the Estate.

Some examples of compensation being reduced are:

- (i) An estate trustees negligent failure to file income tax returns on a timely basis, resulting in interest and penalties;
- (ii) Failing to obtain a reasonable price for an asset of the estate;

- (iii) Failure to invest funds on a timely basis with compensation being reduced by the amount of interest lost;
- (iv) Breaches of Trust

It is rare, however, that an Estate trustee will be deprived of his entire claim to compensation on the basis of mal- administration.

(ii) Pretaking of Compensation

In 1982, in the case of *Re Knoch*¹³, it appeared as though the pre-taking of compensation in Ontario by Estate Trustees was prohibited without the consent of the Court or the agreement of all parties having a financial interest in the Estate.

However, in *Re William George King Trust*¹⁴, two years later, an Ontario court allowed the pre-taking of compensation without the approval of a court provided it was fair, reasonable and earned, and subsequent cases following that line of reasoning forced Estate Trustees who pre-took compensation to pay interest only on the amount that was deemed not to be reasonable¹⁵.

Subsequent to that case, however, cases such as *Re Pilo Estate*¹⁶, *Re Tigert Estate*¹⁷, and *Re Flaska*¹⁸ have reverted to a hard line against the pre-taking of compensation

¹³ (1982), 12 E.T.R. 162 (Ont. Surr. Ct.)

¹⁴ (1994), 113 D.L.R. (4th) 701 (Ont. Gen. Div)

¹⁵ *Re Wright Estate* (1990) 43 E.T.R. 69 (Ont. Gen. Div.)

¹⁶ 1998) O.J. No 4521

¹⁷ (2002) 48 E.T.R. (2d) 301 (Ont. S.C.J.)

¹⁸ [2000] O.J. 2176

and Estate Trustees have been forced to pay interest on all of the pre-paid compensation, regardless of the reasonableness in taking it.¹⁹

At present these hard-line cases appear to the law governing the pre-taking of compensation.

(iii) Priority of an Estate Trustees Claim for Compensation and Expenses

An Executor's claim for expenses and compensation is treated as a lien or charge upon an estate, is considered to be an expense in administering the estate (a testamentary expense), and regardless of the fact that the estate is insolvent, is payable to the Estate Trustee prior to the just debts of the Estate.²⁰ Only funeral expenses precede testamentary expenses.

(iv) TAX TREATMENT

While it is beyond the scope of this presentation to provide tax advice, compensation received by an Estate Trustee is to be included as income in the Estate Trustee's tax return and in some cases it may even be necessary to make installment payments.²¹

Generally speaking, professional Estate trustees are also required to levy G.S.T. on compensation paid to them by an estate. What constitutes a professional estate trustee is a matter of fact, but it is certainly something that an Estate trustee who is a lawyer should be cognizant of, and proper tax advice should be

¹⁹ Re Tigert Estate.

²⁰ Life Assn. of Scotland v. Walker (1876) 24 Gr. 293 (Ont. Ch.), Harrison v. Patterson (1865), 11 G.R. 105 (U.C. Ch.).

²¹ See C.R.A. interpretation bulletin (2005-0113381 E5-April 5, 2005)

sought.

(v) Joint Estate Trustees

The existence of several Estate Trustees does not justify an increase in the total amount of compensation to be paid, and it should also be noted that courts are reluctant to apportion the division of compensation amongst the estate trustees.

CONCLUSION

It is our experience that a great deal of Estate litigation is triggered by claims of compensation and the reaction to those claims by those having a financial interest in an estate.

For that reason, clients should be advised that appointed executor may claim a significant amount of money as compensation for their services, and further that litigation may ensue if the beneficiaries do not feel that the amount claimed is warranted.

By the same token, once an Estate Trustee has retained you, it is imperative that you explain to him what is required in order to make a claim for compensation that can be justified evidentially.

Proper recording keeping is imperative in every case, along with careful and timely attention to the administration of the Estate and the payment of Income taxes. Time docketing is often useful, particularly when a challenge is expected.

It also goes without saying that the Estate trustee must have a clear understanding of the fiduciary nature of his appointed position.

It is the practice of some offices, including ours, to provide an executor with a detailed letter containing all of his obligations and responsibilities. Ours is about ten pages in length.

We also specifically advise them about the vagaries and complications of Estate accounting, and in some cases set them up with a draft set of accounts.

Finally, despite the above, we all know that there is no certainty when a decision is left to a judge. It would make sense to set out a precise formula in a will for how an executor is to be compensated, but with the exception of large estates, and professional executors, this is rarely done.

CAPITAL ENCROACHMENTS

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Capital Encroachments

(Ian M. Hull and Bianca V. La Neve)

Introduction

An important part of advising clients with respect to the administration of an Estate is providing them with advice as to their duties and responsibilities in ongoing trust administration matters.

In this article, we will consider the issue of capital encroachments in the context of trust arrangements established in Wills. Specifically, we will consider whether or not a trustee has the power to encroach on capital and if so, what considerations need to be taken into account by the trustee in determining the amount of the encroachment.

Does the Will Allow the Trustee to Encroach upon Capital?

In determining whether a trustee has the power to encroach upon capital and the scope of such power, one must first look to the specific wording of the Will.

Typically, a testator's Will establishes trusts that provide for income to be paid to a life tenant over their lifetime and capital to be distributed on the death of the life tenant to capital beneficiaries. It is also typical in such trust arrangements to grant the trustee the discretion to encroach upon capital for the benefit of the life tenant.

The following provision is a typical example of a wide power to encroach upon capital:

...to my said trustees to pay to my wife for the benefit of my said wife, such part or parts or the whole of the capital of the residue of my estate as, in their uncontrolled discretion, my said trustees consider advisable.

In interpreting the relevant provisions in a Will, one must endeavor to give effect to the testator's intentions as ascertained from the express language of the Will and the surrounding circumstances. If the language of the Will and/or the specific

capital encroachment provision is unclear, then an Application for the advice and direction of the Court should be brought to determine the extent of the power to encroach.

The Scope and Extent of the Power to Encroach

Once it is determined that the Will grants a power to encroach, the next step is to determine the scope and extent of this power. As can be seen from the example set out above of a typical capital encroachment provision, a trustee is usually granted “uncontrolled discretion” in exercising such power. However, the scope and extent of a trustee's discretion is subject to certain limits.

The Even-Hand Principle

One such limit is a trustee's fiduciary duty to act impartially as between beneficiaries.

In *Water's Law of Trusts in Canada*, the even-hand principle is described as follows:

It is a primary duty upon trustees that in all their dealings with trust affairs they act in such a way that, if there are two or more beneficiaries, each beneficiary receives exactly what the terms of the trust confer upon him and otherwise receives no advantage and suffers no burden which other beneficiaries do not share. In this way the trustees act impartially; they hold an even hand. The settlor or testator may choose to give disproportionate interests to various beneficiaries, and he very often does so in practice, but that is his privilege. It is still the duty of the trustees to carry out the terms of the trust as they find them, and to ensure that in the administration of the trust they do not give advantage or impose burden when that advantage or burden is not to be found in the terms of the trust.¹

In the context of a trust with both income and capital beneficiaries, Waters describes the importance of applying an even-hand approach as follows:

It is the distinction between income and capital that is so important in the context of this rule; here are two classes of beneficiaries, for

¹ D. Waters, M. Gillen & L. Smith, eds. *Water's Law of Trusts in Canada*, 3rd ed. (Toronto: Thomson Canada Limited, 2005), pp. 966-67.

income and capital beneficiaries are interested in different things. With regard to the trust fund the income beneficiary is looking for the best yield obtainable, while traditionally the capital beneficiary is concerned with the safety of the fund. ... It is the duty of the trustees so to manage the fund that they do the best possible for both, and this means holding an even balance between yield and risk.²

A trustee's fiduciary position requires her to maintain an even hand between beneficiaries when exercising a discretionary power, unless the trust provisions specifically authorize the trustee to ignore the even-hand principle and act otherwise. A power to encroach upon capital for the benefit of the life tenant or income beneficiary is usually interpreted as authorizing partiality.

The Exercise of Discretion: No Mala Fides

The concept of *mala fides* has been employed by the courts to limit trustees in the exercise of their discretion to encroach upon capital.

The leading case in this area is *Gisborne v. Gisborne*³. Although *Gisborne* was not strictly speaking an "encroachment" case, it dealt with the underlying issue of the scope of an executor's discretion, particularly in circumstances where the income beneficiary had financial resources of her own.

In *Gisborne*, the Will at issue established a trust fund for the care of the principle beneficiary, the testator's wife, with the trustees being granted "uncontrolled authority" over the application of the trust fund. The principle beneficiary had her own property. She was eventually declared incapable and required full-time care. She argued that the trust fund should be treated as the primary source of funds for her care. The trustees countered that they should only pay her such income from the fund as was required after the beneficiary's own resources had been exhausted.

² *Id* at p. 968.

³ *Gisborne v. Gisborne* (1877), 2 App. Cas. 300 (H.L.) [hereinafter *Gisborne*].

The House of Lords held that the trustees enjoyed an absolute discretion in how they applied the trust fund so long as they did not act with *mala fides* or bad faith:

[the trustees'] discretion and authority, always supposing that there is no *mala fides* with regard to its existence, is to be without any check or control from any superior tribunal⁴.

The *Gisborne* decision was considered and confirmed by the Ontario Court of Appeal in *Fox v. Fox Estate*.⁵ This case dealt specifically with the scope of an executrix's power of encroachment. The Court of Appeal affirmed that the main judicial limitation on the exercise of discretion is whether or not the trustee acted with bad faith or *mala fides*:

The entire question of the degree of control which the courts can and should exercise over a trustee who holds an absolute discretion is filled with difficulty. The leading case, or at least the case to which reference is almost always made, is *Gisborne v. Gisborne*. It stands for the proposition that so long as there is no *mala fides* on the part of a trustee the exercise of an absolute discretion is to be without any check or control by the courts.⁶

The term "*mala fides*" can be broadly interpreted. In *Fox Estate*, Galligan J. held that the term means more than just fraud. The term is sufficiently broad to include acts by a trustee based on "extraneous" matters, that is, considerations which are in fact extraneous to the purposes of the testator as set out in the Will.

An example of trustee action based on "extraneous" matters is found in *Fox Estate*. In this case, the mother was named as the estate trustee of her late husband's estate, and the Will granted her uncontrolled discretion to encroach on the capital of the estate for the benefit of her son's children. When the son married outside of the Jewish faith, the mother used her discretion to give all of the assets to the son's children. Galligan J. concluded that the mother had been motivated to exercise her power to encroach by her disapproval of her son's marriage. He then held that this motivation was entirely extraneous to her duty as executor and that

⁴ *Id.*, per Lord Cairns, at p. 305.

⁵ *Fox v. Fox Estate* (1996), 28 O.R. (3d) 496 (C.A.) [hereinafter *Fox Estate*].

⁶ *Id.* Per Galligan J.A. at para. 11.

it demonstrated sufficient *mala fides* to bring her conduct within any reasonable interpretation of this term.

In holding that courts may interfere if an executor's decision making process is influenced by extraneous matters, Galligan J. relied upon the judgment of Steele J. in *Hunter Estate v. Holton*.⁷

In *Hunter Estate*, Steele J. outlined the scope of a trustee's discretion as follows:

Trustees must act in good faith and be fair as between beneficiaries in the exercise of their powers. There is no allegation of bad faith in the present case. A court should be reluctant to interfere with the exercise of the power of discretion by a trustee. I adopt the following criteria in *Re Hastings-Bass* ... as being applicable to the court's review of the exercise of such power:

To sum up the preceding observations, in our judgment, where by the terms of a trust ... a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he has achieved is unauthorized by the power conferred upon him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account.⁸

Based on our review of the relevant case law, it appears that the general rule is that if the Will provides for unfettered discretion to encroach upon capital, the courts will only reluctantly intervene in the exercise of such discretion unless the trustee has displayed *mala fides*.

An interesting issue arises in cases where a beneficiary has adequate personal resources of her own. May a trustee consider the beneficiary's personal resources when exercising discretion to encroach upon capital? If the capital encroachment provision does not require the trustee to consider such personal resources, is such a consideration "extraneous" to the exercise of the trustee's discretion?

⁷ *Hunter Estate v. Holton* (1992), 7. O.R. (3d) 372 (Gen. Div.) [hereinafter *Hunter Estate*].

⁸ *Id.* at page 379.

In the case of *Re Luke*⁹, the testator named his wife as his principal beneficiary and his executrix. The will provided for the wife to use the income and so much of the capital as she may need for her comfort, maintenance and support during her lifetime. The issue considered by the Court was whether the wife should first exhaust her own financial resources before she could exercise the discretionary power to encroach on the capital.

The Court held that the wife did not have to exhaust her own resources before encroaching on the capital, as there was no specific requirement in the Will that she do so:

Had the testator here intended that his widow should first exhaust her own funds before encroaching on the corpus of his estate he could have used appropriate language to express that intention. His failure to do so must surely indicate that her right of encroachment was an absolute right and not regulated by reference to other means of her own which she might have.¹⁰

Essentially, the Court in *Re Luke* held that if the testator intended the trustee to take into account the personal financial means of the beneficiary, the testator would have used appropriate and clear language to express such an intention.

The issue of whether a trustee is even permitted to inquire as to the personal financial resources of a beneficiary when deciding to encroach upon capital was directly considered in *Hinton v. Canada Permanent Trust Company*¹¹.

In *Hinton*, the testatrix provided for a trust for the benefit of her son. The executors of her estate were her son and a corporate trustee. The Will provided that the executors were to encroach on the capital if the interest income proved "insufficient" for the son's support. For a number of years, the executors paid the interest income to the son as well as an amount representing a capital

⁹ *Re Luke* [1939] O.J. No. 27 (H.C.J.)(Q.L.) [hereinafter "*Re Luke*"].

¹⁰ *Id.* at para. 19. See also *Re King* [1940] O.W.N. 57 (H.C.) and *Re Mattick* (1967), 62 D.L.R. (2nd) 539.

¹¹ *Hinton v. Canada Permanent Trust Co.* [1979] O.J. No. 275 (H.C.)(Q.L.) [hereinafter "*Hinton*"].

encroachment. Eventually, the corporate trustee requested that the son provide information as to his own resources to determine whether the capital encroachment was appropriate. The son refused to provide such information on the basis that he was not obliged by the terms of the Will to do so. The Court agreed with the son and found that the lack of any reference in the Will to the son's income or assets as a factor in determining whether to encroach on the capital of the trust fund was intentional on the part of the testatrix. The son's personal resources were not relevant.

It would appear from the foregoing cases that in the absence of any specific language to the contrary in a Will, a trustee may exercise her discretion to encroach on capital without taking into account the personal financial resources of the beneficiary.

Conclusion

In summary, when providing advice with respect to capital encroachments, the first step is to examine the Will and the intentions of the testator to determine whether a power to encroach on capital has been granted. Once it has been determined that the Will grants a power to encroach, the next step is to determine the scope and extent of this power. Trustees are usually granted "uncontrolled discretion" in exercising their power to encroach. However, the scope and extent of such discretion is subject to the even-hand principle and the prohibition against acting on the basis of *mala fides*.

INVESTMENT ACCOUNTS AND THE PRUDENT INVESTOR RULE

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ESTATE ACCOUNTING

INVESTMENT ACCOUNTS AND THE PRUDENT INVESTOR RULE

INVESTMENT ACCOUNTS

The *Rules of Civil Procedure* require that where an estate trustee has made investments, the estate accounting must set out a separate account showing all money paid out to purchase investments, and all money received by way of repayment or realization on the investments in whole or in part, and the balance of all the investment in the estate at the closing date of the accounts¹.

Essentially, the investment account is a listing of the investment activity of the estate trustee. The accounts reflect use of the assets of the estate that are not considered, strictly speaking, disbursements or receipts. Compensation is not payable with respect to these investments at the usual percentages, as there is no entitlement to compensation in respect of such a disbursement until the investment actually leaves the estate: rather, these investments are usually compensated through the application of the care and management fee.

Purchases are debited to the account, and sales are credited to it.

The investment account does not reflect losses or gains. Debits in this account should equal credits (subject to what remains on investment). Profits or losses are shown in the appropriate disbursement or receipt account.

When reviewing accounts, and in particular, investment accounts, a beneficiary should consider:

¹ Rule 74.17(1)(e)

- Whether the investments are authorized under the Will, and are in accordance with the “prudent investor” rule;
- Whether the investments appear on the investment account only, or whether they appear on the receipts accounts, as well;
- Whether mortgages are properly recorded, with interest being shown in revenue receipts account, and the principal only being recorded in the investment account;
- Whether the trustee invested in its own securities, and if so, whether compensation/fees are being charged; and
- Whether the investment account balances.

THE PRUDENT INVESTOR RULE

Trustee investments are restricted by the terms of the trust, and by legislation. In Ontario, the *Trustee Act* enacts a “prudent investor” rule, which authorizes investment in any property, subject to a statutorily imposed standard of care.

Previously, investments were limited by statute to certain listed investments. In addition, the courts imposed a standard of care on the trustee.

A leading case on the topic is the 1984 English decision in *Cowan and Others v. Scargill and Others*². There, the Chancery Division considered a pension fund that was invested to further certain political and social interests, as opposed to the strictly financial interests of the beneficiaries. V-C Megarry set out some general guidelines that have made their way into almost every discussion of the issue of prudent investors in the context of trustee investment. V-C Megarry stated:

² [1984] 2 All E.R. 750

The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between the different classes of investors.

In the case of a power of investment, ..., the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects of the yield of income and capital appreciation both have to be considered in judgment the return from the investment.

...in considering what investments to make trustees must put on one side their own personal interests and views.

The standard required of a trustee in exercising his powers of investment is that he must take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide

That duty includes the duty to seek advice on matters which the trustee does not understand ... and on receiving that advice to act with the same degree of prudence.

The *Trustee Act* was amended in 1999 to codify the prudent investor rule. The amendments removed the list of allowable investments, and replaced it with a statutorily imposed standard of care.

S. 27(1) provides:

In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

S. 27(2) authorizes investments in any form of property in which a prudent investor might invest.

The provisions of the *Trustee Act* apply to a trust whether created before or after the provisions of the *Trustee Act* came into force: s. 31

In addition to setting out a general standard of care, the *Trustee Act* imposes guidelines that a trustee must follow in planning investments.

The trustee must consider certain enumerated criteria, such as:

- General economic conditions;
- The possible effect of inflation or deflation;
- Expected tax consequences;
- The role of each investment or course of action within the overall portfolio
- The expected total return from income and the appreciation of capital;
- Needs for liquidity, regularity of income and preservation or appreciation of capital;
- An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

Diversification is also required, "to an extent that it is appropriate" to the requirements of the trust and the general economic and investment market conditions

The *Trustee Act* authorizes the trustee to obtain investment advice, and provides that reliance on such advice is not a breach of trust, if a prudent investor would rely on the advice under comparable circumstances. (In *Miller Estate (1987)*, 26 E.T.R. 188 (Ont. Surr. Ct.), Haley J. suggested that in some cases, an executor may be criticized for NOT obtaining investment advise.)

The *Trustee Act* not only allows the trustee to obtain advice, but also allows the trustee to authorize an agent to exercise the trustee's investment functions. However, if the investment function is to be delegated, a written investment plan or strategy is required. Further, the trustee and agent must agree in writing that the agent will comply with the investment plan or strategy, and that the agent will report to the trustee at regular stated intervals. Further sub-delegation is expressly prohibited.

On the issue of delegation, the amended *Trustee Act* puts to an end the issue of delegation and mutual funds. S. 27(3) provides that any rule of law prohibiting a trustee from delegating powers or duties does not prevent eth trustee from investing in mutual funds, pooled funds or segregated funds.

Where authority to invest is to be delegated, the trustee must exercise prudence in selecting the agent, in establishing the terms of the agent's authority, and in monitoring the agent's performance in order to ensure compliance with the investment plan and agreement. The *Trustee Act* sets out specific acts that the trustee must perform in order to monitor the agent's performance: s. 27.1(5)

Where an agent breaches his or her duties, a proceeding for recovery may be brought by the trustee or, where there is delay, the beneficiary.³

Significantly, a trustee is protected from liability for losses to the trust if the conduct of the trustee complied with an investment plan or strategy that involved a reasonable assessment of risk and return that a prudent investor could adopt under comparable circumstances.

If damages are to be assessed, the Court may take into account the overall performance of the investments: losses relating to one investment may not result in damages in light of the performance of other parts of the portfolio.⁴ The court is authorized to look at the performance of the entire portfolio, and the traditional "anti-netting" rule is mollified.

³ S. 27.2(3)

⁴ S. 29

INTEGRATING CORPORATE INFORMATION INTO ESTATE ACCOUNTS

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INTEGRATING CORPORATE INFORMATION INTO ESTATE ACCOUNTS

Pursuant to Rule 74.17 of the *Rules of Civil Procedure*, Estate Trustees are to keep accurate records of all assets and transactions in the estate, and accounts filed with the court shall include:

- a) A statement of the assets at the date of death cross-referenced to entries in the accounts that show the disposition or partial disposition of the assets;
- b) An account of all money received;
- c) An account of all money disbursed;
- d) Where the estate trustee has made investments, an account setting out,
 - i. all money paid out to purchase investments,
 - ii. all money received by way of re-payments or realization on the investments in whole or in part, and
 - iii. the balance of all the investments in the estate at the closing date of the accounts;
- e) A statement of all the assets in the estate that are unrealized at the closing date of the accounts;
- f) A statement of all money and investments in the estate at the closing date of the accounts;
- g) A statement of all the liabilities of the estate, contingent or otherwise, at the closing date of the accounts;

- h) A statement of the compensation claimed by the estate trustee; and
- i) Such other statements and information as the court requires.

The purpose of the accounting is to provide the beneficiaries with information as to the contents of the estate, and what monies have come into and flown out of the estate.

Form of Accounting re Corporate Information

A basic requirement of estate accounting is that there be an entry recorded for every transaction – no matter how insignificant.

As seen above, when estate trustees invest estate money, they must provide details as to the investments made. What happens when a testator owned a company or shares in a company? In the spirit of transparent accounting information, how much detail must the estate trustee provide in his or her accounts with respect to any companies owned, wholly or in part, by the estate?

If a testator owned a private company (either a holding company or an operating company), the asset that would in the normal course be recorded in the accounts is the asset itself i.e. 100 shares of x company – any dividends paid by x company – any redemptions of x company shares, or return of capital on a windup of x company. This means that the transactions internal to the private company are not broken out in detail in the accounts. In essence, there is not much transparency required.

The above may change if a private company is an investment holding company which represents a substantial percentage of the overall estate assets. In such a scenario, simply to record the asset as '100 shares of x corporation', and showing the occasional dividends paid, may not provide sufficient information to assess the work of the executors. In this type of situation, executors are occasionally

asked to prepare a separate set of trustee type corporate accounts setting out the specific detail, under the umbrella of the holding company, to be read in conjunction with the executors' accounts.

There is no distinct rule in respect of the preparation of separate trustee type corporate accounts. However, when the private company represents a large percentage of the overall estate, it would be wise to prepare such accounts. On the other hand, when the company only represents a small percentage of the overall value of the estate, it may be overkill to prepare such accounts.

When integrating corporate information into estate accounts, executors need to take care not to mistakenly intermingle the corporate property and the personally held property, as this might result in situations where corporate assets are realized into the estate and vice-versa. As well, executors must take care not to pay corporate debts by the personal estate and have personal estate debts paid by the corporation.

Disclosure of Corporate Information to Beneficiaries

As mentioned earlier, the purpose of providing accounts to the beneficiaries is to provide them with full information as to the handling of the estate – transparency being the idea. If a separate trustee corporate accounting has not been done for the corporate assets, how much information is the beneficiary entitled to about the underlying corporation?

A wholly owned private company formerly owned by the testator may lead to different disclosure than a situation where the estate owns only part of a corporation. Furthermore, the amount of disclosure may differ where the trustees are directors of the underlying company as they have access to more information than they would as shareholders. Care must be taken to weigh the needs of disclosure, as a beneficiary might want to use the information from the underlying company to establish a competing business, or disclosure of such information might impede the company's proper day-to-day management by the directors.

Only a few cases have examined the rights of beneficiaries to information concerning a company in which the estate/trust holds shares. In these cases a distinction is usually drawn between information held by a trustee as a shareholder as opposed to a director.

Where the information is held by a trustee as a shareholder, the Irish case of *Chaine – Nickson v. Bank of Ireland*, [1976] IR393 held that "a potential beneficiary under a discretionary trust is entitled to copies of the trust accounts and to information as to the investments which represent the trust fund"... including "the balance sheet and profit and loss accounts of [the company]...". In other words, the information concerning the underlying company held by a trustee as shareholder was discloseable in the ordinary way.

In the case of *Stuart Hutcheson v. Spread Trustee Co. Ltd.*, [2002] 5 ITEL 140, the court considered the rights of the beneficiaries to corporate information concerning a company in which the trust held shares. Minutes of members' meetings and the company's accounts were discloseable to the beneficiaries. The court decided this to be the case as the trustees hold shares and rights for the trust's benefit, and as a result, beneficiaries can compel the trustees to exercise their inspection rights as shareholders.

Where information sought is held by the trustee as director, the trustee must recognize that as a director, he/she is accountable to the company, not individual shareholders. Where there is a trust, the question becomes whether the beneficiaries can enforce the trustee shareholder's rights to obtain information which may be otherwise unavailable.

The leading case in this area is *Butt v. Kelson*, [1952] 1 Ch. 197 (Eng CA). In this case, the three trustees of a will trust were the directors of an underlying company. When a beneficiary complained about the company's management, the lower court awarded full disclosure because the trustees were directors, and because their shareholding carried voting power so that each of their acts as

directors were done in execution of their duties as trustees. All documents and records had come into their hands as trustees and as such, a beneficiary under the will was entitled to see them.

The case was appealed, and on appeal the beneficiaries' rights were upheld, but on different grounds. The court determined that beneficiaries were entitled to be treated as though they were registered shareholders of shares of a private company controlled by the estate, and had those rights, including a right to vary the company's articles. Hence, if the court were to award disclosure, it would do so "as a short circuit... to an order compelling [the trustees] to use their voting powers so as to bring about what the plaintiff desires to achieve." Disclosure would only be awarded, however, where the documents sought were properly identified, the beneficiary established a proper case for seeing them and agreed not to disclose to any person besides his legal advisor. Objections from other beneficiaries, or from directors on the company's behalf, could be taken into account, but the court left open whether other shareholders could object.

In the *Spread* decision mentioned above, the court was faced with a decision as to disclosure where a trustee of two discretionary trusts, each of which owned 50% percent of C Ltd., and whose directors were associated companies of the trustee. The trust beneficiaries were the same, except that the applicant had been excluded from one. He sought information about the trusts and C Ltd., including directors' minute books, which company law of that jurisdiction made available to directors, but not to shareholders. The court upheld the request saying, "The question remains whether the minutes of the directors of Cedar are records of the actions of the trustees... we must... look at the substance of the matter. Cedar is... the creature of the trustee... The directors are two companies in the same stable as the trustee. We may... infer that the trustee runs the board. In those circumstances... these minutes... are liable to be produced."

Clearly it was important in this decision that the trustees and directors were essentially the same, and that the trustees were the only shareholders.

DOCUMENTARY DISCLOSURE AND PRODUCTION OF VOUCHERS IN THE CONTEXT OF A PASSING OF ACCOUNTS

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DOCUMENTARY DISCLOSURE AND PRODUCTION OF VOUCHERS IN THE CONTEXT OF A PASSING OF ACCOUNTS

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An estate trustee must always be prepared to account to the beneficiaries of the estate for his or her actions. The beneficiary has a right to an accounting and a right to compel an accounting from the estate trustee. Indeed, the duty to account is one of the hallmarks of a fiduciary relationship.

But it is not enough to simply provide an accounting. An estate trustee is well advised to go the extra step of keeping (and, if the request is made, producing) a complete record of his or her receipts and disbursements incurred in respect of the administration of the estate.

Moreover, the prudent estate trustee will keep a record of all documents and records which in any way deal with his actions in administering the estate. This is defensive practice and the solicitor advising the estate trustee should always alert him or her to be on guard to justify his or her actions in the face of a disgruntled, suspicious or perhaps just curious beneficiary.

Put simply, an estate trustee's accounts will not be sufficient if they can not withstand the scrutiny of the beneficiaries, such scrutiny most commonly exercised in the context of a contested passing of accounts. Any receipt or disbursement itemized in the estate trustee's accounts must be capable of proof. While the estate trustee must verify the accounts on a passing by sworn affidavit and may submit to examination respecting the accounts, there is no substitute for a good paper trail. A judge hearing a contested passing of accounts will likely take the side of the beneficiaries and consider the

remedies of surcharge and forfeiture if sufficient evidence of receipts and disbursements is not tendered. A defence that such evidence was innocently misplaced or simply not kept will not be favourably received.

The law seems well settled that the beneficiaries of an estate have what has been called a "joint proprietary interest" in all documents related to the administration of the estate, the rationale for the creation of this interest being that such documents relate to work directly or indirectly incurred for their benefit.

So, for example, if an estate trustee maintains an estate residence as part of his administration of an estate, she will want to keep copies of invoices rendered by, for instance, public utilities, the property insurer and the municipal property tax authority, together with proof of payment of same. Proof of payment will consist of cancelled cheques, detailed bank account statements or receipts of payment from the relevant creditor.

If the estate trustee passes her accounts and a Notice of Objection to Accounts is filed with respect to such disbursements, proof of the expense will be required.

All such back up documents are commonly referred to as "vouchers." The vouchers should be made available for inspection and, if requested, copied by the concerned beneficiary (usually at that person's expense in the first instance.

How far does this obligation on the part of the estate trustee extend? The caselaw seems settled that the beneficiaries are entitled to virtually every document which is in any way relevant to the administration of the estate.

Accordingly, the estate solicitor is acting prudently if he advises his client to retain all documents related to the affairs of the estate, no matter how seemingly insignificant or irrelevant such documents may appear.

The estate trustee's concern must be not only to prove that expenses (for example) were incurred and paid. She must also anticipate having to explain why certain expenses were paid.

So, for instance, if the estate trustee engages and receives a legal opinion from the estate solicitor that a slip and fall claim incurred on the estate residence needs to be defended, the beneficiaries would be entitled to that opinion and the estate trustee would, of course, be well advised to retain that opinion to defend himself against the argument that legal fees were needlessly incurred by the estate.

Solicitor/client privilege between the estate trustee and the estate solicitor will not, in most routine cases, bar the beneficiaries from inspecting such documents, the reason being again that the beneficiaries have a joint proprietary interest in such communications (*Goodman Estate v. Geffen*, [1991] 2 S.C.R. 353 (S.C.C.)). However, when the estate trustee engages legal advice to defend herself against attack from the beneficiaries, there ceases to be a commonality of interest and the privilege would apply.

Note that an estate trustee who is given an absolute discretion (for example, with respect to whether to encroach on capital for the benefit of a life tenant) arguably has no obligation to the beneficiaries to explain how that decision is made. There is conflicting

authority as to whether, if the rationale for such decisions is reduced to writing, such document is to be produced to the beneficiaries. It can be argued that such document is an exclusion to the general rule that the beneficiaries are entitled to inspect documents relating to the administration of the estate (*Londonberry's Settlement, Re*, [1965] 1 Ch. 918 (Eng. C.A.)). However, the Court will enquire into allegations of the inappropriate exercise of discretion by an estate trustee and may choose to consider such evidence notwithstanding this apparent exclusion to the general rule (*Schipper v. Guaranty Trust Co. of Canada* (1989), 69 O.R. (2d) 386 (Ont. C.A.)).

Having regard to compensation, the estate trustee should keep copies of all documents that directly impact upon the "five factors" with a view towards justifying a claim for compensation. Correspondence passing back and forth between the estate trustee and beneficiaries, creditors, and any other parties can serve to demonstrate the complexity of the administration or the quantum of time expended in and about the affairs of the estate. As such, production of such documentation in the context of a contested passing of accounts will be compelling evidence to corroborate the claims made by the estate trustee for compensation.