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THE AVAILABILITY OF TRUST FUND INCOME FOR CHILD SUPPORT

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A spouse who has significant family wealth may be the beneficiary of a trust fund and may receive income and/or capital from the trust at the discretion of a trustee, who is often a close family member. The question then arises as to whether funds received or that *could be* received from the trust ought to be included in the calculation of income for the purposes of child and spousal support. The courts must balance the reality that grandparents and other relatives have no obligation to support the children and former spouses of their own grown children and relatives[1] with the family law principle that the children's lifestyle ought not to be significantly different in each parent's house.[2]

Discretionary Family Trusts

Discretionary family trusts serve several useful functions. They are used to:

(i) Accumulate property on a tax-free basis;

(ii) Transfer future income and wealth to a taxpayer's family on a tax-free basis. Those family members are able to use their lower marginal tax rates when receiving income and capital distributions from the trust; and

(iii) Exercise control over young or spendthrift beneficiaries.

It is important to recognize that the entire framework of the ***Federal Child Support Guidelines***[3] (the "*Guidelines*") is based on hourly or salaried employees. Special provisions in sections 16 to 19 assist the court in adjusting income in situations where a payor spouse earns income other than as a salaried employee.

Like the *Guidelines*, the ***Spousal Support Advisory Guidelines*** refer to imputing income to a payor spouse. They do not, however, expressly provide for how this should be done. Instead, they adopt the methodology prescribed by the *Guidelines*. However, the inclusion of income related to a discretionary trust may be different for spousal support purposes when the recipient spouse is entitled to a share in the trust as a result of the equalization payment. The law discourages this kind of double recovery.[4]

For Canadian courts, the exercise of setting the amount of support where the payor is the beneficiary of a discretionary family trust is complicated by the determination of what amount of funds related to the trust should be included in the calculation of the beneficiary's income.

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1 ***Fein v. Fein***, 2001 CarswellOnt 4150, [2001] O.J. No. 4554 (Ont. S.C.J.) at paras. 27-35, additional reasons 2002 CarswellOnt 7883 (Ont. S.C.J.).

2 ***Francis v. Baker***, 1998 CarswellOnt 931, [1998] O.J. No. 924 (Ont. C.A.) at para. 64, affirmed 1999 CarswellOnt 2734, 1999 CarswellOnt 2948 (S.C.C.).

3 SOR/97-175.

4 ***Boston v. Boston***, 2001 SCC 43, 2001 CarswellOnt 2432, 2001 CarswellOnt 2433 (S.C.C.).

Where a spouse is receiving income from a trust, it is difficult to argue that the amount should not be included in the calculation of income for support. However for the most part, Canadian courts are reluctant to include capital disbursements as income, even when there is a regular pattern of capital withdrawals. However, recent case law suggests that it might be appropriate to attribute a reasonable rate of return on the capital disbursements received.

We have not found any decision where an Ontario court has imputed income to the beneficiary of a discretionary trust based on the amount of income accumulating in a discretionary trust that was not actually paid out to the beneficiary. Under the right circumstances, the argument could be made that if accumulating income is not included in income for support, the beneficiary would be allowed to amass his or her own wealth at the expense of his or her children. The right circumstances would likely include a trust that is run by close family members of the trustee.

The Ontario Court of Appeal in ***Bak v. Dobell***,[5] has held that income that *could be* earned from capital is relevant to child support and will be included in income.[6] This is unsurprising given section 19(1)(e) of the *Guidelines*, which provides that the court may impute income to a parent or spouse in circumstances where the parent's or spouse's property is not reasonably utilized to generate income.[7] But what of property that is not held by the parent or spouse and is held instead by a trust?

Section 19(1)(i) of the *Guidelines* provides that a court may impute such amount of income to a spouse as it considers appropriate in some circumstances, which include the following:[8]

> (*i*) the spouse is a beneficiary under a trust and is or will be in receipt of income or other benefits from the trust.

The discretion to scrutinize income and benefits received or that will be received from a trust allows the court to more accurately assess income and identify money that should be available to the children of trust beneficiaries after the dissolution of their parents' relationship. Section 19(1)(i) is designed to address the unfairness that would result if a spouse and his or her family was to artificially manipulate his or her income through a trust for the purpose of avoiding support obligations.

In ***Laurain v. Clarke***,[9] Price J. considered whether annuity payments that the husband received from his mother's estate should be included in his income for the purpose of calculating child support. The wife argued that it was income and the husband argued that it was capital. Justice Price agreed that the annuity payments were capital but ascribed a reasonable rate of interest on the capital of the annuity payments and treated that as income. The interest rate that he ascribed was 5% and he added that to the husband's income.[10]

In coming to His Honour's conclusion, Price J. relied on the decision of the Supreme Court of Canada in ***Leskun v. Leskun***:[11]

> The Supreme Court of Canada in *Leskun v. Leskun*, 2006 SCC 25, held that a capital asset is part of a payor spouse's "means." The court may therefore base the amount of support which a payor must pay on the income that an asset, such as money in the bank, a pension, trust, or annuity, is capable of generating.
>
> I interpret the Court's decision in *Leskun* to mean that a capital asset that a person receives in the form of periodic payments should not itself be treated as income for the purpose of calculating support, but should be treated as part of his means, so that the income which it is reasonably capable of generating should be included in his income for the purpose of calculating his support obligation.

The annuity payments on which the rate of return was calculated in *Laurain v. Clarke* were actually received.

In ***R. (E.J.) v. A. (K.D.)***,[12] the Supreme Court of British Columbia went even further and imputed income to the payor spouse who was the beneficiary of a trust based in part on the *potential* for his receipt of income from the trust, which was the return on the trust's capital investment.[13]

Courts have considered income related to equity compensation in a support case where a spouse had control over when to exercise shares. However, the issue becomes complicated with a discretionary beneficiary who legally has no control over when and how income is paid to him or her.

In ***Patterson v. Patterson***,[14] the husband had been receiving Restricted Share Units (RSUs) which were held in trust by the bank, a third of which vested each year. Justice McLaren found that it would be fair to deem that an employee will exercise the shares as soon as they are vested. Justice McLaren had expert evidence before her that most employees choose to take delivery when the shares vest because the tax on a capital gain is significantly lower than tax on income. In addition, it would be inappropriate to deny the amount of money for support purposes that could accumulate if the employee chose to defer the exercise of the shares (paras. 102, 104 and 105).

A similar argument can be made with respect to income earned from capital held by a trust: it would be inappropriate to allow a beneficiary of a trust to accumulate wealth inside the trust at the expense of paying child support. However, there is one important difference between the husband in *Patterson* and the beneficiary of a discretionary trust. The husband in *Patterson* had control over whether to take delivery of the RSUs. A beneficiary of a discretionary trust often has no such control, at least on paper. However, where the trustees are close family members of the beneficiary, the issue of control may be different.

Ontario courts have held that it is appropriate to consider the maximum potential amount available to a beneficiary of a trust where the beneficiary has a close personal relationship with the trustee:

[5] 2007 ONCA 304, 2007 CarswellOnt 2324 (Ont. C.A.).
[6] *Bak v. Dobell, supra* note 5, at para. 55.
[7] *Guidelines*, s. 19(1)(e).
[8] *Ibid.*, s. 19(1)(i).
[9] 2011 ONSC 7195, 2011 CarswellOnt 13729 (Ont. S.C.J.).
[10] 2006 SCC 25, 2006 CarswellBC 1492 (S.C.C.). *Laurain v. Clarke, supra* note 9, paras. 44-45.
[11] *Laurain v. Clarke*, *supra* note 9, paras. 44-45.
[12] 2002 BCSC 1649, 2002 CarswellBC 3115 (B.C.S.C.).
[13] *R. (E.J.) v. A. (K.D.), supra* note 12, at paras. 221 and 223.
[14] 2006 CarswellOnt 8904, [2006] O.J. No. 5454 (Ont. S.C.J.) (additional reasons 2007 CarswellOnt 4354 (Ont. S.C.J.)).

Waese v. Bojman.[15] In that case, the court had to determine the mother's income for *Guidelines* purposes, a great deal of which came from family trusts and her father's estate. Given her close relationship to the trustees (one of whom was her sister), it was appropriate to consider the maximum potentially available to the mother under the trusts and the estate. Averaging the income paid over several years would not produce a fair estimation. The reasoning of the court is captured in the following paragraph:[16]

> Ms. Bojman's current financial statement shows that she currently receives employment income of $1,100 every two weeks, net of tax, from a family corporation. Counsel suggest that this is equivalent to about $40,000 of pre-tax income. The provisions of the trusts, and her late father's estate, authorize the trustees to supplement her income to a maximum of $52,000 per year, net of all taxes. This base figure was to be indexed from 1987, and now would be equivalent to about $77,000 net, per year. Counsel agree that this amount is equivalent to about $107,000 of gross income per year. Ms. Bojman has not received trust income in the past, since her other income has exceeded this figure. Given her relationship with the trustees (one of whom is her sister) and the interrelationships among the various closely held corporations, some of which pay her income, I am satisfied on the balance of probabilities that she could easily have access to the maximum amounts from the trusts and other income sources, namely the equivalent of $107,000 gross income. Her 2000 "total income" on her tax return was only $39,000, compared nearly $300,000 in each of 1999 and 1998, and well over $700,000 in 1997. Given the huge fluctuations in income, averaging would not, in my view, produce a fair estimation of her income. I believe looking at the maximum potentially available under the trusts and estate to be a more realistic estimate of her income for the coming year.

It is unclear from the decision in *Waese v. Bojman*, whether the income the wife was receiving from the trust was capital disbursements or income. Clearly the court did not consider this to be of significance in determining the amount of income to impute.

In ***Lay v. Lay***, the Divisional Court upheld the decision of Benotto J. ordering that the wife pay interim interim child support on the basis of income earned from a discretionary trust.[17] The asset base of the trust was over $2 million. In ordering interim interim and retroactive child support, Benotto J. noted, "I have no doubt that her needs will be looked after by the trustees."[18] On appeal, the Divisional Court noted that it had no reason to doubt the correctness of Benotto J.'s decision.

Conversely, in ***Belcastro v. Belcastro***,[19] the court was satisfied that in the past, the mother had never received any income from revocable trusts although she had declared income for tax purposes in turns with her mother at the instruction of her aunt who controlled the trusts. While the court was aware of section 19(1)(i) of the *Federal Child Support Guidelines*, it was not persuaded that the mother "is or will be in receipt of income or other benefits from the trust".[20] Revocable trusts can be differentiated from discretionary trusts in that they are typically used for the benefit of the settlor.

Capital Distributions as Income for Support Purposes

Distributions of capital from a trust are generally not treated as income for the purposes of determining child support; however in some cases the courts have included such amounts as income. Exceptions to the general rule were identified by the court in *Laurain v. Clarke*:[21]

> (a) [where] the court has based its calculation of support on the income that the payor was capable of earning, but did not, because he chose to live on his capital instead; or
>
> (b) where it was unfair, in circumstances of temporary economic necessity, to require the recipient to make a sudden adjustment to a significantly lower standard of living by reason of separation from a spouse who has customarily treated such capital receipts as income.

Neither of these circumstances was present in that particular case.

However, the facts in ***Jackson v. Jackson***, presented Pardu J. of the Ontario Court of Justice with the perfect opportunity to include capital distributions as income:[22]

- the husband was working only part-time as a bus driver, after terminating his employment as a police officer when he became a beneficiary of a testamentary trust with assets of approximately $1.2 million;
- the trust was paying out approximately $105,000 in capital to the husband annually;
- the parties had enjoyed a lengthy marriage; and
- there was a substantial history of use of the trust to support a luxurious lifestyle for the parties during the marriage.

Justice Pardu reasoned that, for the purposes of the Guidelines, the definition of income was not limited to income in the traditional sense:[23]

> Where there is a substantial history of use of capital to support a joint lifestyle, and where there has been a moderately lengthy marriage, I do not believe that a spouse should necessarily be relegated to a lifestyle appropriate to income only, rather than the other means available to the spouse, at least on an interim basis.
>
> This would in this case result in too abrupt a transition from the lifestyle enjoyed before separation to post-separation lifestyle and does not equitably apportion the changes resulting from the breakdown of the marriage on an interim basis.
>
> In making an order for interim support, the Court is required to consider the condition, means, needs and other circumstances of each spouse. "Means" are not necessarily limited to income (*Reid v. Reid* (1995), 11 R.F.L. (4th) 85 (B.C. C.A.)).

[15] 2001 CarswellOnt 1813, 19 R.F.L. (5th) 220 (Ont. S.C.J.).
[16] *Waese v. Bojman*, *supra* note 15, para. 5.
[17] 1997 CarswellOnt 4083 (Ont. Div. Ct.).
[18] *Lay v. Lay*, *supra* note 17, para. 10.
[19] 2004 CarswellOnt 1994, [2004] O.J. No. 2077 (Ont. S.C.J.).
[20] *Belcastro v. Belcastro*, *supra* note 19, para. 18.
[21] *Supra* note 9, at para. 102. See also ***Colivas v. Colivas***, 2013 ONSC 168, 2013 CarswellOnt 193 (Ont. S.C.J.) at paras. 13 and 30. In *Colivas*, Boswell J. made an interim order for support that, "in all likelihood, will require Mr. Colivas to encroach upon capital to meet". Justice Boswell found that he was entitled to override the general well-settled rule that support is payable from income and not capital because the parties had a significant history of using a combination of capital and income to fund their lifestyle.
[22] 1997 CarswellOnt 4717, [1997] O.J. No. 4790 (Ont. Gen. Div.) at paras. 2-8.
[23] *Jackson v. Jackson*, *supra* note 22, paras. 20-23.

> It is clear from what is included in income for the purposes of the child support guidelines, that income for those purposes is not limited to "income" in the traditional sense. One may also envisage many costs for which parents may be obliged to resort to capital, such as university or orthodontic expenses.

The argument that capital disbursements from a trust should be treated as income was also made in ***Paniccia v. Butcher***,[24] with a different result. In that case, the mother had obtained a meagre order for child support four months before the father received a significant distribution from his own father's testamentary trust.[25] The father spent a portion of the money on a house and invested the balance. Thereafter, he began making regular monthly withdrawals of $1,000 from the investment for his own support. He also began receiving income from the trust in the amount of approximately $400 per month, which was the only item reflected on his Line 150 income.[26]

The mother asked the court to impute annual income to the father for the relevant taxation year based on the capital sum of $295,000, grossed up to $526,400 to reflect its tax-free status.[27] The court declined to make such an order. Surprisingly, the court also refused to impute income to the father based on his regular monthly receipt of capital distributions from the trust, concluding as follows:[28]

> Certainly clause 19(1)(e) did not apply in Mr. Butcher's situation, because a professional manager of the trust had as its goal to generate income. Although there was a regular pattern of capital withdrawals of $1,200 a month to the father for personal living expenses in *Dalton v. Craig* (Mr. Butcher did the same), Justice Mackinnon did not consider that depletion of one's own capital as income, where the depletion did not itself give rise to a taxable consequence. Hence, this case is a good authority not to treat Mr. Butcher's 1998 and 2003 capital disbursements as income upon which income could be imputed for guideline purposes.

The court in *Paniccia v. Butcher* relied on ***Dalton v. Craig***[29] as authority for the proposition that a court should not treat depletion of one's own capital as income even where there was a regular pattern of capital withdrawals, if the depletion itself did not give rise to a taxable consequence. In *Dalton v. Craig*, the court found that there was no evidence led to show that the father had not taken reasonable steps to generate income from his capital. Accordingly, the court did not accept the submission that the father's income should be determined on the basis of the amount of capital he depleted each year for his own support.

It is to be noted that in both *Paniccia v. Butcher* and in *Dalton v. Craig*, the recipient wives did not make the alternative argument that was made in *Laurain v. Clarke*: the court should impute a reasonable rate of interest on the capital disbursements.

Guidance from case law dealing with gifts from family members

Despite the general rule that "usual gifts, such as those given to mark a special occasion" are not to be included in income, the Ontario Court of Appeal has recognized that under section 19(1) of the *Guidelines* a court will consider whether the circumstances surrounding the particular gift are so unusual that they constitute an "appropriate circumstance" in which to impute income: *Bak v. Dobell*.[30]

The Court of Appeal in *Bak v. Dobell* set out a list of factors which ought to be considered in considering whether it is appropriate to include the receipt of unusual gifts in income:[31]

(a) the regularity of the gifts;

(b) the duration of their receipt;

(c) whether the gifts were part of the family's income during cohabitation that entrenched a particular lifestyle;

(d) the circumstances of the gifts that earmarked them as exceptional;

(e) whether the gifts do more than provide a basic standard of living;

(f) the income generated by the gifts in proportion to the payor's entire income;

(g) whether the gifts are paid to support an adult child through a crisis or period of disability;

(h) whether the gifts are likely to continue; and

(i) the true purpose and nature of the gifts.

The Superior Court of Justice, in both it 2011 decision of ***Lo v. Mang***[32] and, more recently (2015) in ***Horowitz v. Nightingale***,[33] found that regular gifts from family members could be considered income for support purposes.

In *Lo v. Mang*, the father received monthly payments in the amount of $2,250 or $27,000 per year from his parents. In addition, there was evidence that a number of the cheques were not signed by the father's parents, but by the father himself and his sister. The court drew an adverse inference from the failure of the father's parents to testify.[34]

More recently, Douglas J. in *Horowitz v. Nightingale*, attributed $50,000 per year grossed up on the basis of regular gifts made by the father's parents. In that case, the court based its decision on two central facts: the husband had been receiving $50,000 per year from his parents for at least past 8 years; and the money received from his parents was applied to support his family's lifestyle. The court recognized that while there was no obligation on the part of the husband's parents to continue making gifts in the same amount with the same regularity, or at all, it was safe to conclude that such gifts would be likely to continue into the immediate foreseeable future.[35]

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[24] 2003 CarswellOnt 1753 (Ont. C.J.), additional reasons 2003 CarswellOnt 1754 (Ont. C.J.).
[25] *Paniccia v. Butcher, supra* note 24, paras. 6 and 19.
[26] *Paniccia v. Butcher, supra* note 24, paras. 19 and 20.
[27] *Paniccia v. Butcher, supra* note 24, para. 24.
[28] *Paniccia v. Butcher, supra* note 24, para .37.
[29] 2001 CarswellOnt 4551, [2001] O.J. No. 5117 (Ont. S.C.J.), additional reasons 2002 CarswellOnt 624 (Ont. S.C.J.), reversed in part 2002 CarswellOnt 4203 (Ont. Div. Ct.).
[30] *Supra* note 5, at para. 74.
[31] *Bak v. Dobell, supra* note 5, para. 75.
[32] 2011 ONSC 496, 2011 CarswellOnt 411 (Ont. S.C.J.).
[33] 2015 ONSC 190, 2015 CarswellOnt 204 (Ont. S.C.J.), additional reasons 2015 CarswellOnt 3890 (Ont. S.C.J.).
[34] *Lo v. Mang*, supra note 32, paras. 102-103.
[35] *Horowitz v. Nightingale*, supra note 33, para. 23.

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Even a gift that is not made on a regular basis can be considered in the determination of income. In *Ellis v. Carpenter*,[36] the husband received $100,000 as a gift from his mother, in the form of a motor home worth $20,000 and $80,000 in cash.[37] The court held that it was inappropriate to attribute all of the funds received by the husband as income for the purpose of child support and distinguished the circumstances in that case from *Jackson v. Jackson*, above, since in *Jackson*, there was a series of annual payments of capital and in *Ellis v. Carpenter*, there was a one-time payment.[38] The court held that it was reasonable for the father to keep the $20,000 motor home without having to convert it into an income-producing asset and to repay loans and debts of $27,500. However, the remainder of the money gifted to him could have generated income. The court attributed $2,500 to the father annually since the year in which he received the gift.[39]

It can be seen from case law dealing with both distributions from trusts and gifts from family members that courts are reluctant to exclude regular sums received by a support payor from a trust controlled by a non-arm's length party (in the case of a trust) or directly from a non-arm's length party (in the case of gifts). When a spouse receives a one-time gift or capital distribution from a trust, the court is unlikely to impute income of the entire amount gifted or received from the trust. Instead, the court will rely on section 19(1)(e) of the *Guidelines* and determine whether the property received ought to be utilized to generate income. If the answer is yes, the court will ascribe a reasonable rate of return to the underutilized property, which will be included in the spouse's income. It remains to be seen whether the court will consider income accumulating inside a trust, at the discretion of a trustee who is a close family member of the support payor, to be income for the purpose of support.

[36] 1999 CarswellOnt 884, [1999] O.J. No. 934 (Ont. Gen. Div.).
[37] *Ellis v. Carpenter, supra* note 36, at paras. 9-10.
[38] *Ellis v. Carpenter*, *supra* note 36, para. 10.
[39] *Ellis v. Carpenter*, *supra* note 36, paras. 11-13.

2014 FAMILY LAW UPDATE FOR ESTATE AND TRUSTS LAWYERS — PART VII

By Daniel S. Melamed, Lindsay G. Mills, and Robert L. Barbiero*

V. Miscellaneous Cases of Interest: The Intersection of Estates and Family Law (cont'd)

2. Katz v. Katz

(a) Overview

The relevance of ***Katz v. Katz***[1] to family law and estates law does not arise from the specific issues raised in the case. Rather, the Ontario Court of Appeal, in assessing one of the Respondent's arguments, embarked on a discussion of the court's power under the *Family Law Act*[2] ("*FLA*") and the ***Divorce Act***[3] to order a payor spouse to obtain life insurance to secure support payments that are binding on the payor spouse's estate.

(b) Facts

Orly Katz ("the Appellant") and Neil Katz ("the Respondent") were married for 18 years prior to separating in May 2004. During the course of their relationship, the parties had three children. In April 2010, the parties were divorced by court order.[4]

The divorce order contained a number of requirements relating to support payments. As well, the divorce order contained the requirement that the Respondent obtain life insurance and designate his children as the beneficiaries of the policy.[5] The obligation to obtain life insurance was tied to the Respondent's obligation to provide support payments.[6]

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[1] 2014 ONCA 606 (Ont. C.A.).
[2] R.S.O. 1990, c. F.3.
[3] R.S.C. 1985, c. 3 (2nd Supp.).
[4] *Katz v. Katz*, *supra* note 1, at para. 8.
[5] *Katz v. Katz*, *supra* note 1, at para. 9.
[6] *Katz v. Katz*, *supra* note 1, at para. 20.

The relevant portion of the divorce order reads:

> 66. [The Respondent] shall obtain and maintain life insurance in the amount of $500,000.00, with the children named as beneficiaries and [the Appellant] named as trustee, and:
>
> (a) He shall provide [the Appellant] a copy of the said policy within sixty (60) days of the release of these reasons for judgment.
>
> . . . . .
>
> (c) When [the Respondent's] obligation to pay child support and spousal support ends, he will be free to deal with the policy as he deems fit, and [the Appellant] shall sign whatever documents are necessary in order to effect this intention.
>
> . . . . .
>
> (e) In the event of a review of child support, section 7 expenses, and/or spousal support, the requirement for life insurance may be adjusted and shall reflect sufficient security.[7]

In May 2013, the Appellant brought a contempt motion against the Respondent. The grounds of the motion were that the Respondent failed to abide by the divorce order as it related to support payments and obtaining life insurance.[8] The motions judge dismissed the Appellant's motion because, as noted by the Court of Appeal, "[t]he evidence is such [that] I am satisfied that the respondent has complied with the [divorce order]."[9] The Respondent was unable to obtain an insurance policy despite his reasonable efforts to do so because he was diagnosed with prostate cancer after conducting required medical tests for an insurance application. As a result, he could not find an insurer who would provide him with a policy.[10] In these circumstances, the motions judge was satisfied that the Respondent was in compliance with the divorce order.

The motions judge's decision was appealed.

(c) Issue

The Appellant raised four issues on appeal. The relevant issue for our purposes is:

[7] *Katz v. Katz*, *supra* note 1, at para. 24.
[8] *Katz v. Katz*, *supra* note 1, at para. 10.
[9] *Katz v. Katz*, *supra* note 1, at para. 15.
[10] *Katz v. Katz*, *supra* note 1, at para. 14.

> Can a court order a payor spouse to obtain life insurance to secure support payments that are binding on the payor's estate?[11]

(d) Analysis and Decision

The Appellant argued that the motions judge erred in finding that the Appellant could not insure the Respondent's life and collect life insurance premiums directly from the Respondent.[12] The Respondent relied on the Divisional Court's decision in ***Feinstat v. Feinstat***[13] to argue that it would be improper for a court to order him to obtain life insurance where it was not reasonable for him to attain a policy.[14]

While agreeing with the Respondent that the appeal on this ground should be dismissed, the Court of Appeal was concerned that the Respondent's argument undermined a court's ability to require a spouse to obtain life insurance.[15]

In addressing this concern, the Court of Appeal concluded that, based on the plain wording of the statutes, the *FLA* and *Divorce Act* were broad enough to allow a court "to order a spouse to obtain insurance to secure payment of support payments that are binding on the payor's estate."[16] Regarding the *FLA*, the court noted that section 34(1)(i) empowers a court to "make an interim or final order . . . requiring that a spouse who has a policy of life insurance as defined under the *Insurance Act* designate the other spouse or child as the beneficiary."[17] While not specifically giving a court power to require a spouse to obtain life insurance, section 34(1)(k) of the *FLA* provides discretion for a court to secure a support payment through a charge on property "or otherwise".[18] Given that section 34(4) of the *FLA* provides that an estate will be bound by a support obligation unless the order states otherwise, the court concluded:

> s. 34(1)(k) is broad enough to permit a court to order a spouse to obtain an insurance policy to secure payment of the order following the payor spouse's death. The concluding words "or otherwise" in s. 34(1)(k) afford the court broad scope for securing the payment of a support order.[19]

Although the *Divorce Act* does not contain similar provisions, the court found, by analogy, that the court has discretion to order a payor spouse to obtain life insurance to secure support payments after death that are binding on the payor's estate.[20] The court held that although there is no specific provision in the *Divorce Act* that binds a payor's estate, Ontario jurisprudence holds that the court has the power to bind a payor's estate by specifically noting that the support payments will continue past the payor spouse's death in the support order.[21]

The court provided practical ways how it should approach cases where a payor spouse does not have an existing insurance policy in place:

- evidence of the payor's insurability and the plans available should be considered when making an order for a payor to obtain life insurance;
- regarding the quantum of insurance, courts should not order an amount that exceeds the support ordered. A court should order an amount less than required to cover the total amount owing under the support order where there are investment opportunities available to the recipient spouse;
- the amount of insurance ordered by the court to be obtained by the payor spouse should decrease as the total amount owing under the support order decreases;
- when the support obligation comes to an end, so should the requirement to maintain life insurance; and
- when dealing with orders under the *Divorce Act*, the court should specifically note in its order that the support obligation binds the payor's estate.[22]

VI. Conclusion

The year 2014 was another interesting one. Our discussion of the statutory amendments to the *PBA* (Parts I and II, January and February 2015), the issue of estate freezes (Parts III and IV, March and April 2015), limitation periods for constructive trust and dependent support claims (Part V, May 2015), and other cases of interest (Part VI, June 2015) highlight the need for practitioners in the areas of family, estates, and trusts law to be aware of the recent developments in our respective fields.

[11] *Katz v. Katz*, *supra* note 1, at para. 55.
[12] *Katz v. Katz*, *supra* note 1, at para. 55.
[13] 2012 ONSC 5339 (Ont. Div. Ct.).
[14] *Katz v. Katz*, *supra* note 1, at paras. 57, 65-66.
[15] *Katz v. Katz*, *supra* note 1, at para. 65.
[16] *Katz v. Katz*, *supra* note 1, at para 73.
[17] *Family Law Act*, *supra* note 2, at s. 34(1).
[18] *Ibid.*, at s. 34(1)(k).
[19] *Katz v. Katz*, *supra* note 1, at para. 69.
[20] *Katz v. Katz*, *supra* note 1, at para. 71.
[21] *Katz v. Katz*, *supra* note 1, at para. 72.
[22] *Katz v. Katz*, *supra* note 1, at para 74.

WHEN LEGAL WORLDS COLLIDE: THE IMPACT OF CORPORATE LAW ON FAMILY LAW RIGHTS AND OBLIGATIONS FOLLOWING A RELATIONSHIP BREAKDOWN — PART II

By Robert M. Halpern*

II. Legal Tests for Piercing the Corporate Veil (cont'd)

1. Piercing the Corporate Veil in General

Canadian judges have offered a host of considerations when determining whether the corporate veil should be pierced. The "alter ego" test prohibits individuals from using the corporation for an "illegal, fraudulent or improper purpose."[1] Under this test, the corporate veil can only be pierced if the corporation's separate legal personality is being used as a "conduit ... to avoid liability."[2] The broader "flagrantly unjust" test allows judges to exercise their discretion if failing to pierce the corporate

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[1] ***642947 Ontario Ltd. v. Fleischer*** (2001), 56 O.R. (3d) 417 (Ont. C.A.), at para. 68; ***Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.*** (1996), 28 O.R. (3d) 423, [1996] O.J. No. 1568 (Ont. Gen. Div.) at para. 22, affirmed 1997 CarswellOnt 3496, [1997] O.J. No. 3754 (Ont. C.A.).
[2] ***Gregorio v. Intrans-Corp***. (1994), 18 O.R. (3d) 527 (Ont. C.A.) at p. 536 (additional reasons (1994), 15 B.L.R. (2d) 109n, 1994 CarswellOnt 3827 (Ont. C.A.)).

veil would be "flagrantly opposed to justice."[3] This test applies if those in control of the corporation "expressly direct a wrongful thing to be done."[4] In Canada, the "alter ego" test is the predominant one and some disagreement exists as to whether the "flagrantly unjust" test provides discretion that is too broad.[5]

The leading Ontario case applying the tests for piercing the corporate veil is *642947 Ontario Ltd. v. Fleischer*, which was decided by the Ontario Court of Appeal in 2001.[6] Justice Laskin considers when the corporate veil ought to be pierced and found that the determination is largely fact-specific:[7]

> These authorities indicate that the decision to pierce the corporate veil will depend on the context. They also indicate that the separate legal personality of the corporation cannot be lightly set aside. Yet, however restrictive corporate law principles for piercing the corporate veil may be, in the context of an undertaking to the court, the trial judge's findings support going behind Sweet Dreams and imposing personal liability.

In *Fleischer*, the court found the trial judge made no error in piercing the corporate veil to hold shareholders personally liable for damages that flowed from the breach of an agreement.

More recently in 2012, the Alberta Court of Appeal in *Elbow River Marketing Limited Partnership v. Canada Clean Fuels Inc.* summarized the circumstances where courts and academics have found that the corporate veil may be pierced in a variety of legal contexts:[8]

- where express and clear statutory provisions permit it;
- where a corporation is formed for the express purpose of doing a wrongful act;
- where once incorporated, those in control expressly direct a wrongful thing to be done (including criminal activity);
- where there is fraud or manifestly improper conduct akin to fraud;
- where one entity acts as an agent of another;
- where two seemingly separate entities are in fact one common enterprise (but the veil will be lifted only to benefit third parties);
- where the corporation is a mere agent, or "alter ego", of the controlling shareholder or other party (as noted above, control is not enough; requires wrongful, unlawful, fraudulent or improper conduct);
- where there is a trust relationship;
- where shareholders disregard the corporate form (especially in their dealings with others, as in when persons hold themselves out to the public without identifying their corporate status);
- sometimes, where it can be shown the corporation was too thinly capitalized to conduct the business for which it was formed (but this has been doubted);
- in certain family law cases to provide for child support, etc.;
- in certain tax cases; or
- in the interest of national security, such as in time of war, if the corporation is controlled by persons resident in the enemy territory.

At trial, Tillman J. referred to piercing the corporate veil as a "vivid but imprecise metaphor."[9] The court in *Elbow River* ultimately agreed with Tillman J. that at trial it was too soon to determine whether the corporate veil should be pierced.[10]

While the legal tests for piercing the corporate veil have undergone significant developments in Canadian jurisprudence, the precise nature and scope of the doctrine remains unsettled.[11] In each case, the corporation's separate legal personality will be disregarded depending judge's discretion and the facts of the case.

2. Piercing the Corporate Veil in Family Law

Family law jurisprudence has refined the court's approach for piercing the corporate veil to take into account specific obstacles of the family law litigant *vis-à-vis* the corporation. In 2006, the Ontario Court of Appeal released three family law decisions that consider piercing the corporate veil: ***Wildman v. Wildman***, ***Debora v. Debora***, and ***Lynch v. Segal***.[12] Together, these cases have created a list of factors for courts to consider:

- the history of the spouse's business affairs;
- the purpose and use of the corporation;
- whether third-party interests will be affected;
- injustice in the context of family law; and

[3] ***Kosmopoulos v. Constitution Insurance Co. of Canada***, [1987] 1 S.C.R. 2 (S.C.C.), at para. 12; ***Elbow River Marketing Limited Partnership v. Canada Clean Fuels Inc.***, 2012 ABQB 277 (Alta. Q.B.) at para. 176 (reversed in part 2012 ABCA 328 (Alta. C.A.)).

[4] ***Clarkson Co. v. Zhelka*** (1967), 64 D.L.R. (2d) 457, [1967] O.J. No. 1054 (Ont. H.C.), at para. 80.

[5] Thomas G. Heintzman and Brandon Kain, "Through the Looking Glass: Recent Developments in Piercing the Corporate Veil" (2013), 28 B.F.L.R. 525, at p. 539; Douglas T. Yoshida and Lyndsey S. Delamont, "Piercing the Corporate Veil: A Canadian Overview and Risk Assessment", *Annual Review of Civil Litigation* (Toronto, Thomson Carswell, 2014), at p. 413; Howard J. Feldman, "Piercing the Corporate Veil in Family Law Cases", unpublished manuscript (prepared for the Law Society of Upper Canada Continuing Legal Education Program, April 5, 2007), at p. 5.

[6] *642947 Ontario Ltd. v. Fleischer*, *supra* note 1, at para. 73. Recently, in ***Shoppers Drug Mart Inc. v. 6470360 Canada Inc.***, 2014 ONCA 85 (Ont. C.A.) (leave to appeal refused 2014 CarswellOnt 8633 (S.C.C.)), the Ontario Court of Appeal emphasized that the motions judge should have referred to the test in *Fleischer* to determine when to pierce the corporate veil in Ontario.

[7] *Fleischer*, *supra* note 1, at para. 68.

[8] *Elbow River*, *supra* note 3, at para. 182, referenced in ***Elbow River Marketing Limited Partnership v. Canada Clean Fuels Inc.***, 2012 ABCA 328 (Alta. C.A.), at para. 17.

[9] *Elbow River* (Alta. Q.B.), *supra* note 3, at para. 184, citing ***Re Polly Peck International Plc***, [1996] 2 All E.R. 433, [1996] B.C.C. 486 (Eng. Ch.), at p. 497.

[10] *Elbow River* (Alta. C.A.), *supra* note 8, at para. 17.

[11] Yoshida and Delamont, *supra* note 5, at p. 410. See also *Kosmopoulos*, *supra* note 3, at para. 10, citing ***Salomon v. Salomon & Co.*** (1896), [1897] A.C. 22 (U.K. H.L.).

[12] *Wildman v. Wildman* (2006), 273 D.L.R. (4th) 37, [2006] O.J. No. 3966 (Ont. C.A.); *Debora v. Debora* (2006), 275 D.L.R. (4th) 698, [2006] O.J. No. 4826 (Ont. C.A.); *Lynch v. Segal* (2005), 2005 CarswellOnt 8735, [2006] O.J. No. 5014 (Ont. C.A.).

- consistency with family law and corporate law legislation.[13]

A court is likely to find that the corporate veil should be pierced if the spouse has control over a corporation that it uses to defend and/or avoid a legitimate family law entitlement.

In *Wildman v. Wildman*, the Ontario Court of Appeal upheld a trial judge's order requiring all amounts owed to the wife to be secured and enforceable not only against the husband personally, but also against his businesses.[14] In this case, the wife sought spousal and child support from her former husband, who owned several construction and landscaping companies and earned about $700,000 annually. The court found the corporate veil could be pierced because the husband was the sole owner and controller of the businesses and that he diverted assets through his businesses for his own personal use.[15] Writing for a unanimous court, MacPherson J. wrote that it would be "flagrantly opposed to justice to allow the appellant to hide behind a corporate veil that he does not himself respect."[16] Although the businesses themselves were not given notice of the litigation, the court found the businesses were indirectly given notice by virtue of being the husband's "alter ego".[17]

In *Debora v. Debora*, the Ontario Court of Appeal also upheld the trial decision, which allowed the corporate veil to be pierced. The husband was ordered to pay an equalization payment of $3.3 million, as well as retroactive and ongoing support. The trial judge found that although the husband's company purchased a cottage property, it was nevertheless a matrimonial home within the meaning of the ***Family Law Act***[18] ("FLA") and subject to the net family property calculation. Relying on *Wildman v. Wildman*, Weiler J. held that the company was the husband's "alter ego", especially given that the husband was the corporation's sole shareholder and controlling mind.[19]

The Ontario Court of Appeal's decision *Lynch v. Segal* refers to both *Wildman v. Wildman* and *Debora v. Debora* when it finds that the husband was the beneficial owner of certain companies for the purpose of calculating the property and support claims.[20] The husband attempted to conceal his involvement with lucrative land development by requiring his lawyer to act as the sole shareholder, director and officer of certain corporations.[21] Justice Blair upheld the trial judge's finding that the husband and the companies were "one and the same" and that it was an appropriate case to pierce the corporate veil.[22]

Wildman v. Wildman, *Debora v. Debora* and *Lynch v. Segal* confirm that family law litigants will not be permitted to hide behind corporations in an attempt to avoid family law claims. Courts tend to inform themselves of the corporation's underlying purpose and tend to consider the spouses' actions throughout the litigation. In each of these cases, counsel and judges were required to consider corporate law legal tests and apply them to address family law objectives.

Part III of this article will appear in the 30-8 issue of *Money & Family Law*, to be published August 2015.

[13] *Debora*, *supra* note 12, at para. 22; *Lynch v. Segal*, *supra* note 12; *Wildman v. Wildman*, *supra* note 12, at para. 49.
[14] *Wildman v. Wildman*, *supra* note 12, at para 14.
[15] *Wildman v. Wildman*, *supra* note 12, at paras. 43-44.
[16] *Wildman v. Wildman*, *supra* note 12, at para. 46.
[17] *Wildman v. Wildman*, *supra* note 12, at paras. 47 and 48.
[18] R.S.O. 1990, c. F.3.
[19] *Wildman v. Wildman*, *supra* note 12, at paras. 28-29.
[20] *Lynch v. Segal*, *supra* note 12, at para. 63.
[21] *Lynch v. Segal*, *supra* note 12, at para. 11.
[22] *Lynch v. Segal*, *supra* note 12, at paras. 20 and 38.

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