THE POUR-OVER CLAUSE IN A CROSS-BORDER CONTEXT

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INTRODUCTION

With all the career and job opportunities available, many Canadians and Americans choose to cross the border to pursue new goals. Providing trust and estate planning advice to Canadians living in the United States and Americans living in Canada is no longer a rare situation. Where an individual has spent part of his[1] life in one country and part in the other, his will and power of attorney may have been executed in one country but not amended following the arrival in the other country. In case of incapacity or death, this may cause serious headaches to family members. Even though *inter vivos* and testamentary trusts are used in both Canada and the United States, the estate planning strategies differ depending on the jurisdiction in which implemented. For example, U.S. revocable trusts, also called living trusts and grantor trusts, are frequently used in the United States. For assets transferred to the trust while the grantor is alive, the U.S. revocable trust avoids the probate process and acts as a will substitute. Those assets are transferred in accordance with the provisions of the trust, not the will.

A U.S. revocable trust may also be used to receive assets upon the grantor's death. One mechanism to achieve a transfer of assets from the grantor's estate to the revocable trust is the pour-over will that includes a pour-over clause. A pour-over will covers assets that were not transferred into the U.S. revocable trust while the grantor was alive. A pour-over clause is a provision directing that all or part of the grantor's estate be added to the corpus of an existing trust which is revocable and amendable. The validity of the pour-over clause is recognized in the United States. However, in Canada, courts have been hesitant to recognize the validity of a pour-over clause included in a Canadian will.

TYPES OF TRUSTS IN CANADA

For Canadian tax purposes, a testamentary trust is a trust that arose on and as a consequence of the death of an individual.[2] An "*inter vivos* trust" means a trust other than a testamentary trust. It is a trust set up during the settlor's lifetime or a testamentary trust that has lost its qualification as a testamentary trust. The person setting up an *inter vivos* trust is generally referred to as the "settlor" whereas the testator would be the person creating a testamentary trust.

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1 In this text, the masculine includes the feminine and is used only to ease the reading.

2 Subsection 108(1) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supplement), as amended, hereinafter referred to as the "I.T.A."

In Canada, *inter vivos* trusts are typically set up to hold private company shares to split income and capital gains among the beneficiaries and for asset protection.

As for testamentary trusts, a spousal testamentary trust may be recommended where the testator wishes to maintain some control over assets following the testator's death, while benefiting from the rollover that allows a transfer of assets at death on a tax-deferred basis.[3] Taxes are payable upon death of the surviving spouse,[4] and the remaining assets may be transferred outright to beneficiaries or to testamentary trusts.

Where assets are transferred to a testamentary trust that does not qualify as a spousal testamentary trust, the deceased individual is deemed to have disposed of his assets[5] immediately before death and income taxes are payable on the accrued gain.[6] Fifty percent of the gain is taxable.

Prior to 2016, the main difference between an *inter vivos* trust and a testamentary trust was that income earned by the testamentary trust was taxed at graduated rates, as is the case for individuals, while the income earned by an *inter vivos* trust was taxed at the highest marginal tax rate. Tax savings could be obtained by splitting income between the testamentary trust and the trust beneficiaries. For example, if the trust had two beneficiaries, it was possible to tax part of the trust income inside the trust at graduated rates, and to tax part of the trust income in the hands of the beneficiaries. Tax savings could be realized, especially where the beneficiaries had no other income. In addition, prior to 2016, the spousal testamentary trust was a popular tax strategy as income could be split between the trust and the spouse. Beginning in 2016, the spousal testamentary trust no longer provides tax benefits. For non-spousal testamentary trusts with several beneficiaries, tax savings can still be achieved by splitting income among the beneficiaries.

Therefore, prior to 2016, considering the tax savings that could be achieved with a testamentary trust, using an *inter vivos* trust to transfer assets at death was not a widespread strategy. But things changed in 2016, when the Canadian government decided to tax income from both *inter vivos* and testamentary trusts at the highest marginal tax rate.[7] The same applies at the provincial level. As such, a trust pays tax on its income at the highest marginal tax rate applicable in the province where the trust resides.

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3 Subsection 70(6) I.T.A.

4 Or if the trust sells assets.

5 Some exceptions apply.

6 Subsection 70(5) I.T.A.

7 Subject to two exceptions, one being an estate that qualifies as a graduated rate estate or G.R.E. for the 36-month period following the death of the testator and the other being a qualified disability trust set up for an individual who may claim the Canadian disability tax credit. These trusts may benefit from the graduated tax rates (but for a maximum of 36 months for the G.R.E.).

REVOCABLE TRUSTS IN CANADA

The Canadian Income Tax Act contains provisions allowing a taxpayer to set up an *alter ego* trust,[8] if aged 65 or over, or a self-benefit trust.[9] In both cases, assets can be transferred to the trust on a tax-deferred basis and the trust can generally be revoked during the settlor's lifetime. Taxes are payable when the trust sells assets and upon the settlor's death.

Whereas a self-benefit trust may not have contingent beneficiaries, an *alter ego* trust may. An individual aged 65 or over may transfer property to an *alter ego* trust on a rollover basis if the following conditions are met:[10]

- The trust was created after 1999.
- The trust and the individual are resident in Canada.
- The individual is entitled to receive all the trust income during his lifetime.
- No other person than the individual may, before his death, receive or otherwise obtain the use of any of the income or capital of the trust.

Even though only the settlor may receive or obtain the use of any of the income or capital of the trust during his lifetime, the trust may include contingent beneficiaries who may receive income and capital from the trust following the settlor's death. This strategy allows for assets to be transferred according to the provisions of the *inter vivos* trust, rather than under a will. For example, Mother could set up an *alter ego* trust to which she transfers her real estate and investment portfolio. This transfer will be made on a tax-deferred basis. The trust can provide that upon her death, her children will become beneficiaries of the trust. The assets within the trust are not subject to probate and the beneficiaries can access the assets without delay.

As such, the *alter ego* trust can be used in the estate planning context as a will substitute. However, as the trust document will not deal with all the steps required to liquidate the estate, and as some assets may be kept outside the trust, a simple will to govern the liquidation of the estate usually would be drafted.

When choosing which assets should be transferred to an *alter ego* trust, one must remember that pension plans such as Registered Retirement Savings Plans and Registered Retirement Income Funds, cannot be transferred to a trust without triggering tax. Property such as an investment portfolio, a principal residence, a cottage, rental property, shares of operating and holding companies, and cash can be transferred to the *alter ego* trust. The *alter ego* trust also serves as a tool for asset protection purposes.

The *alter ego* trust may be set up as an alternative to a power of attorney or enduring power of attorney (or protection mandate in the province of Quebec) for managing the assets of the settlor. This may be appropriate when the settlor has health problems that affect his mental capacity, such as Alzheimer's disease, or if there are doubts about the attorney's honesty and integrity. The settlor may be one of the

[8] A joint spousal or common-law partner trust may also be set up. In such a case, taxes are payable upon death of the surviving spouse. Subsection 248(1) I.T.A.

[9] Subsections 73(1), (1.01)(c)(ii), and (1.02)(ii) I.T.A.

[10] Subsections 73(1), (1.01)(c)(ii), and (1.02)(i), and 248(1) I.T.A.

trustees and should he lose capacity, the trust will remain in place, with the remaining or replacement trustees.

Prior to 2016, using an *alter ego* trust for estate planning purposes could have triggered higher taxes. But since 2016, as explained above, income from both types of trusts is taxable at the highest marginal tax rate. As such, from a tax rate point of view, there is no difference between the two anymore.[11]

Considering the conditions that must be met for a trust to be an *alter ego* trust, a U.S. revocable trust would most likely not qualify as an *alter ego* trust.

Another point worth mentioning is that while a U.S. revocable trust is ignored for U.S. tax purposes, it is treated as a regular trust in Canada. This means that a transfer of assets to the U.S. revocable trust while the grantor/settlor is alive would trigger a deemed disposition for Canadian tax purposes and taxes would be payable on the accrued gains.[12]

THE POUR-OVER CLAUSE IN THE U.S.

A U.S. revocable trust (also called living trust or grantor trust) refers to a trust that is set up during the lifetime of the grantor, that can be amended and totally revoked while the grantor is alive.

The revocable trust is often used as an estate planning strategy. As mentioned above, assets can be transferred to the trust while the grantor is alive or upon the grantor's death. One advantage of the revocable trust is that it avoids the probate process upon the grantor's death on the assets that have been transferred to the trust while the grantor was alive. In case of incapacity or death, the trust may continue and is not automatically wound up. When used to transfer assets upon the grantor's death, a pour-over clause will often be used. As already mentioned, a pour-over clause is a provision directing that all or part of the grantor's estate be added to the corpus of an existing trust.

THE POUR-OVER CLAUSE IN CANADA

Situations where a pour-over clause may be used or considered in the Canadian context include the following:

- A U.S. citizen who set up a U.S. revocable trust while living in the United States moved to Canada on a permanent basis and wishes to transfer his Canadian assets to the U.S. revocable trust upon his death.

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[11] But before using the *alter ego* trust as a will substitute, the type of assets held by the taxpayer must be reviewed, as well as the possibility of transferring assets on a tax-deferred basis to a surviving spouse or spousal testamentary trust. As taxes will be payable upon the settlor's death, assets held inside the trust cannot be transferred to a spouse or to a spousal testamentary trust on a rollover basis.

[12] A U.S. revocable trust may raise tax issues for an individual who is a Canadian resident for tax purposes, such as double tax and a mismatch of foreign tax credits. These issues are however beyond the scope of this article.

- A Canadian parent with a child living in the United States is looking for a strategy to reduce the child's exposure to U.S. estate tax and is then considering adding a pour-over clause in his Canadian will. A properly drafted U.S. revocable trust would be set up while the Canadian parent is alive for the benefit of the U.S. child and his children. This trust would generally be set up with a nominal amount. Following the Canadian parent's death, the U.S. revocable trust would receive assets from the parent's estate to reduce the child's exposure to U.S. estate tax.

However, based on case law, is a pour-over clause a valid technique to transfer Canadian assets at death?

"Regarding the revocable trust, one interesting point is that in addition to being amendable and revocable, the trust included a provision allowing the trustees to change the beneficiaries."

WHAT DO THE COURTS IN CANADA THINK ABOUT THE POUR-OVER CLAUSE?

In British Columbia

Kellogg Estate

In *Kellogg Estate (Re)*,[13] the court was asked to decide whether a real estate property located in British Columbia known as the "Musgrave Farm" could be transferred to a U.S. revocable trust under a pour-over clause found in a will made while the testator was living in Washington.

Robert Payne Kellogg and his wife made their wills in the U.S. in 1994 and a U.S. revocable trust was created at the same time (the "KF Trust").

Robert Payne Kellogg passed away on April 15, 1999, when he was living in Washington.

Regarding the revocable trust, one interesting point is that in addition to being amendable and revocable, the trust included a provision allowing the trustees to change the beneficiaries. The trust was amended after the will was executed to remove one of the beneficiaries of the trust.

The following provisions were found in the deceased's Will:

> Residue of Estate
>
> [a] I give, devise and bequeath all the rest, residue and remainder of my property of every kind and description (including lapsed legacies and devises), wherever situated and whether acquired before or after the execution of this Will, to the Trustee under that certain Trust executed by me, which is known as [the KF Trust]. * * *
>
> [b] If for any reason the said Trust shall not be in existence at the time of my death, or if for any reason a court of competent jurisdiction shall declare the foregoing testamentary disposition to the Trustee under said Trust as it exists at the time of my death to be invalid, then I give all of my estate including the residue and remainder thereof to that person who would have been the Trustee under

[13] 2013 BCSC 2292, 2015 BCCA 203.

said Trust, as Trustee, and to their substitutes and successors under the Trust, as such trust is described hereinabove.

Justice Gray held that to recognize the validity of the pour-over clause would allow Robert Payne Kellogg to change his will without having to comply with the requirements of the *Wills Act* of British Columbia.[14] For the court, a gift cannot "pour over" on terms which did not exist at the time the will was executed. Consequently, a pour-over clause to a revocable, amendable, *inter vivos* trust is invalid. The fact that the trust could be amended in the future and that it was amended was determinative.

After concluding that the pour-over clause was invalid and mentioning that there is a strong presumption against intestacy, Justice Gray reviewed the provision of the will mentioned above under [b] called the Incorporation by Reference Clause applicable should the pour-over clause be declared invalid. After analyzing the requirements for incorporating a document in a will, Justice Gray indicated that the Incorporation by Reference Clause incorporates the terms of the KF Trust indenture, which governed the trustee on the date that Robert Payne Kellogg executed the will. Justice Gray came to the conclusion that the Musgrave Farm is to be held on a testamentary trust which is on the same terms as the KF Trust, without amendment, and with the result that the initial beneficiaries have an equal share in the Musgrave Farm. The beneficiary that was removed by the trustees was then added back.

Quinn Estate

The validity of a pour-over clause was also reviewed by the court in *Quinn Estate*.[15]

Pat Quinn, a former well-known head coach and general manager in the National Hockey League was a Canadian and American citizen. His wife, Sandra, had a green card and was a Canadian citizen. While living in the U.S., Pat Quinn set up a U.S. revocable trust for his wife and himself. The trust was settled on March 4, 1996. The trust deed provided that Pat Quinn and his spouse could withdraw property from the trust as well as amend it.

On April 1, 1996, Pat Quinn executed a will in respect of his Canadian assets. The Canadian will was prepared by his U.S. attorney and was executed in British Columbia. All the requirements for proper execution of a will were met.

In March 1997, Pat Quinn made some changes to the revocable trust so that it would qualify as a qualified domestic trust ("Q.D.O.T.").

Under the revocable trust, Pat and Sandra Quinn were the first beneficiaries. Upon death of the surviving spouse, assets held in Canada were to pour over in the U.S. revocable trust for the benefit of Pat Quinn's adult daughters Valerie and Kathleen. At the time of his death, on November 23, 2014, Pat Quinn was living in British Columbia.

Sandra Quinn, in her capacity as executor of the Canadian will of Pat Quinn, was seeking the court's determination as to whether a pour-over clause was invalid.

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[14] Which was repealed by the Wills, Estates and Succession Act ("*WESA*"), SBC 2009, c. 13, s. 193, effective March 31, 2014.

[15] 2018 BCSC 365, 2019 BCCA 91.

Under British Columbia law, to be valid, a will must meet all of the following requirements:

- It must be in writing.
- It must be signed at its end by the will-maker, or the signature at the end must be acknowledged by the will-maker as his or hers, in the presence of two or more witnesses present at the same time.
- It must be signed by two or more of the witnesses in the presence of the will-maker.

Although Pat Quinn's Canadian lawyer advised him, upon his return to Canada, to wind up the revocable trust and revise his estate plan, Pat Quinn unfortunately passed away before he could make the required changes.

In finding the pour-over clause to be invalid, the court stated:

> [49] The Legislature's purpose in requiring particular formalities for the proper execution of a will is to ensure certainty as to the deceased's final wishes and to avoid controversy (and possible litigation). The possible use of a revocable, amendable, *inter vivos* trust as the recipient of a testamentary gift, bequest or devise creates that uncertainty the Legislature sought to avoid. Put bluntly, a person could one day execute his or her will, fully observing the execution strictures of s. 37(1) of WESA, leaving the residue of his or her estate to a revocable, amendable, *inter vivos* trust, which he or she could then revoke or amend the following day without regard to any execution strictures.
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> [50] Having two witnesses present at the time of a will-maker's execution of his or her will or codicil serves to protect against fraud or undue influence, or the perception of such, thereby helping to ensure certainty of the will-maker's final wishes. A well-founded perception that there is the protection against fraud or undue influence often serves to maintain, give, or secure family harmony, especially as the will-maker approaches his or her later part of life.

The court saw two problems with the revocable trust. The first problem was that since the trust was amendable and revocable and had in fact been amended after the execution of Pat Quinn's will, this amounted to an amendment not made in compliance with the formalities of the British Columbia's Wills, Estates and Succession Act.

The second problem is that since the trust can be amended, it cannot be known with certainty how the property will devolve upon Pat Quinn's death since the transfer of the property is governed by terms not found in the will itself.

Pat Quinn's daughter, Valerie, tried to convince the court to uphold the validity of the pour-over clause that transferred the Canadian assets to the U.S. revocable trust. Her lawyer urged the court to distinguish this situation from *Kellogg Estate* where the amendment involved a change in beneficiaries as opposed to a change of an administrative nature.

Unfortunately, the court concluded that the clause was invalid, and that the residue of the property should be vested according to the rules of intestacy.

The court of appeal for British Columbia refused to apply the doctrine of Incorporation by Reference to validate the pour-over clause because as of the date of Pat Quinn's will, the trust, being amendable and revocable, was not a presently existing document and a testator cannot, by his will, create for himself a power to dispose of his property by an instrument not duly executed as a will or codicil under British Columbia law.

Waslenchuk Estate

In *Waslenchuk Estate*,[16] the court applied the same reasoning as in *Quinn Estate*. In *Waslenchuk*, the testatrix set up a revocable trust and had her will prepared in November 2013 while she was living in Connecticut. Her will and the revocable and amendable *inter vivos* trust were executed in accordance with the formal requirements in force in that jurisdiction. Mrs. Walenchuk was looking for a vehicle to manage her assets in case of incapacity, provide for the ultimate distribution of her assets upon her death, and minimize the impact of probate.

However, she came back to British Columbia, where she was domiciled at the time of her death in 2016. Under her will, the residue of her estate was to be distributed to the revocable trust. The Supreme Court of British Columbia held that even though the revocable trust was never amended following the signing of the will, the pour-over clause was invalid.

The court referred to section 101 of the British Columbia Wills, Estates and Succession Act that indicates that regardless of where a will is made, the administration of an estate of a deceased person who was ordinarily resident or domiciled in British Columbia at the date of the person's death is governed by the statute:

> [54] A testamentary document such as a will is meant to reflect the testator's fixed and final intentions for the disposition of his or her estate upon death. A testator may change those intentions by revoking a will and executing a new one or by executing a codicil to the existing will, so long as the requirements in *WESA* are complied with.

In Nova Scotia

MacCallum Estate

There is one case decided by the Supreme Court of Nova Scotia, *MacCallum Estate*,[17] that approached the issue of the validity of a pour-over clause differently. It focused on whether there had in fact been an amendment or revocation of the trust after the will was executed.

Royal Trust Corporation of Canada ("Royal Trust") was the executor of the last will and testament of Helen F. MacCallum, and the trustee of the Helen MacCallum Alter Ego Trust. She passed away in 2020. The Royal Trust applied to the court for an interpretation of the legal effect of the will, specifically clause 3(d) that states:

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[16] 2020 BCSC 1929.

[17] 2022 NSSC 34.

> *Rest of my Estate*. Pay or transfer the rest of my estate to Royal Trust, as trustee of the Helen MacCallum Alter Ego Trust (the "Trust"), to be added to the capital of the Trust and administered and distributed in accordance with the terms of the Trust. The receipt of the trustee of the Trust shall be a sufficient discharge and release to all concerned without any need to inquire into or investigate the terms of the Trust. If the Trust does not exist at my death, distribute the rest of my estate on the same trusts, terms and conditions as the Trust as it existed as of the date of this will.
>
> Although I wish to note it here for the benefit of my trustees, I expressly do not incorporate the trust Helen MacCallum Alter Ego Trust establishing the Trust into my will be reference and it does not form part of my will. I want it to remain a private document.

The Supreme Court of Nova Scotia upheld the pour-over clause in *MacCallum*. Because (i) the trust was created before the signing of the will, (ii) it was funded, and (iii) its terms had not been changed since the signing of the will, the considerations raised in *Kellogg* and *Quinn Estate* were not applicable. For the court, recognizing the validity of the will is supported by the public presumption against intestacy and is in keeping with the clear intentions of the testatrix. The court added that the requirements provided under the Wills Act to make sure a will is valid were enacted to protect the testator against fraud and undue influence and to make sure the testator has testamentary capacity. But it remains important to respect the testator's wishes and where there is a will, there is a presumption that the transfer of assets upon death should not be made under the rules of intestacy.

"The Royal Trust was then authorized as executor of the will to pay and transfer the residue of the estate to the alter ego trust."

The Royal Trust was then authorized as executor of the will to pay and transfer the residue of the estate to the *alter ego* trust.

In Ontario

Vilenski v. Weinrib-Wolfman

However, this is not the end of the story as the *Vilenski v. Weinrib-Wolfman*[18] court case, rendered in Ontario after *MacCallum Estate*, applied the findings in *Kellogg* and *Quinn*. The pour-over provision found in a will made in 2017 that indicated that the residue of the estate had to be paid to an *alter ego* trust that was set up before the signing of the will was declared invalid even though there were no changes to the trust after the making of the 2017 will. The trust was set up in March 2016. For the court, the mere possibility that the trust be modified is an issue. The formalities required for a will to be valid are not respected.

Tal Vilenski who was the estate trustee of the estate of Lynda Weinrib and trustee of the Lynda Weinrib Alter Ego Trust was questioning the validity of the pour-over clause in Lynda Weinrib's will, considering that there was no decided case that he could find in Ontario that deals directly with the validity of a pour-over clause.

The pour-over clause in Lynda Weinrib's will reads as follows:

> 4. (d) Residue My Estate trustee shall pay or transfer the residue of my estate to the trustees of The Lynda Weinrib Alter Ego Trust (the

[18] 2022 ONSC 2116.

> said trust having been established by me immediately prior to the signing of this my Will) who are holding such office at the time of my death or, if there is no person holding the said office at the time of my death, the trustees who are first appointed to such office after my death.

The fact that the adult children beneficiaries under the will were prepared to consent to a declaration that the pour-over clause was valid did not change anything.

The court compared the reasoning and approach taken by the courts in British Columbia and Nova Scotia and adopted the reasoning in the *Quinn Estate* case and determined that the pour-over clause in the 2017 will was not valid.

In Quebec

With respect to the province of Quebec, the courts have not been asked to consider the validity of a pour-over clause.

However, as is the case in other Canadian provinces, the formalities governing the various kinds of wills must be observed, on pain of nullity. In the province of Quebec, three forms of wills are recognized: the notarial will, the holograph will, and the will made in the presence of witnesses. However, if a will made in one form does not meet the requirements of that form of will, it is valid as a will made in another form if it meets the requirements for validity of the other form. As such, pending a court decision on this matter, upon death, it might be prudent to transfer assets to a testamentary trust as opposed to a revocable *inter vivos* trust.

CONCLUSION

In Canada, each province has specific legislation applicable to wills and estates and strict requirements must be met for a will to be valid.

Where the strict formality requirements for testamentary documents are not followed, assets are transferred on intestacy.

Given the state of the case law in Canada, if a pour-over clause is to be included in a will, estate planning practitioners should consider creating the trust directly in the Canadian will as opposed to having a separate document. The idea is to mirror the provisions of the revocable trust in the will.

Should a separate document be more appropriate, considering the facts and circumstances, another option may be to set up an irrevocable trust, instead of a revocable trust.

To be even more cautious, adding “backup” language in the will to avoid intestacy should be considered.

In any event, it will be interesting to see if courts from other provinces will follow *Quinn Estate* or will rather agree with the findings in *MacCallum Estate*.

There is no doubt that the combined expertise of Canadian and U.S. estate planning experts can be of great value when dealing with cross-border tax and legal issues and may prevent unpleasant surprises for individuals with ties to both Canada and the United States.