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CENTRAL MANAGEMENT AND CONTROL DETERMINES THE RESIDENCY OF A TRUST FOR PROVINCIAL TAX PURPOSES

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Individuals and families whose tax plans include trusts should take note of the recent decision of the Supreme Court of Newfoundland and Labrador in *Discovery Trust v Minister of National Revenue* ("**Discovery Trust**")[1] – the first case to deal with the issue of the residency of a trust for provincial tax purposes following the Supreme Court of Canada's decision on trust residency in *Fundy Settlement*.[2] It is significant for confirming that the "central management and control" test set out in *Fundy Settlement* also applies in the domestic context to ascertain the provincial residency of a trust. It also establishes some guiding principles relevant to taxpayers in determining where a trust is resident for provincial tax purposes.

Trusts are deemed to be individuals for the purposes of income tax in Canada, and the taxable income of a trust is subject to both federal and provincial taxes. The taxation statutes, however, are silent on how to determine the residency of a trust. An earlier decision of the Federal Court was widely accepted as establishing that a trust is resident where its trustee is resident.[3] Many taxpayers relied on the tax planning opportunities generated by this decision to establish off-shore trusts. This understanding came due for a revision, however, in light of the Supreme Court of Canada's decision in *Fundy Settlement* that the residency of a trust in the cross-border context was where its central management and control abided.

Discovery Trust centered on a tax plan designed to allow a trust, most of whose beneficiaries were resident in one province, to take advantage of lower tax rates in effect in another province. The Discovery Trust (the "**Trust**") was settled by the founder of CHC Helicopter Corporation, Craig L. Dobbin, for the benefit of the Dobbin children, most of whom resided in Newfoundland and Labrador. The Dobbin children were initially made trustees of the Trust, but shortly before the death of the settlor, they resigned and the Alberta office of Royal Trust Corporation of Canada ("**Royal Trust**") was appointed as successor trustee. At the same time, the assets of the Trust were moved to Alberta (which had more favourable tax rates than Newfoundland and Labrador) and the laws governing the trust were changed to those of Alberta.

The Minister of National Revenue (the "**Minister**") reassessed the taxpayer on the basis that the Trust was resident not in Alberta, but in Newfoundland and Labrador. Pointing to a number of transactions involving property of the Trust, the Crown argued that the Dobbin children, as beneficiaries, either directly or indirectly

made all the decisions concerning the management and control of the Trust and that Royal Trust, as new trustee, was merely responsible for administrative tasks. The Crown argued that, since the central control and management of the trust was in Newfoundland and Labrador, it was a resident of that province and thus subject to that province's income tax regime. If the Trust was resident in Alberta, it would save about $9 million in tax.

The Court confirmed that central management and control is the test for residency for provincial tax purposes. The Court reviewed each of the transactions at issue to determine where central management and control was exercised. The Court found that no substantial decisions were made by the beneficiaries such that control could be said to have been delegated to them. In reaching this conclusion, the Court provided some important guidance about the administration of trusts that individuals should keep in mind when engaging in tax planning:

1. First, the Court found that, absent action taken under a statutory anti-avoidance provision, it is inappropriate for the Minister to reassess on the basis of a taxpayer's motivation to arrange affairs in a manner designed to minimize taxes payable. This is consistent with existing jurisprudence and long-standing principles of Canadian tax law. Case law also confirms the Minister's general obligation to refrain from recharacterizing a *bona fide* legal relationship on the basis that another transaction structure would have resulted in the payment of more taxes.
2. Second, where a trustee is required to approve a transaction in respect of trust property (e.g., as shareholder of shares held in trust), trustee actions that may appear routine and passive do not necessarily indicate an abdication of control and management by the trustee. Reviewing the details of the proposed transaction, acquiring explanations sufficient to make an informed decision, reviewing the trust's governing documents to ensure that the proposed approval is within the trustee's authority, and properly considering the consequences of the transaction for the beneficiaries generally are within the powers of a trustee.
3. Third, a difference of opinion between trustee and beneficiaries can exist and a trustee can acquiesce to the demands of a beneficiary without giving up its authority over trust property. For example, in *Discovery Trust*, Royal Trust withheld, at the beneficiaries' request, a lower amount in respect of a tax liability than it had originally planned; the Court found that this did not result in an abdication of its control. Consultation by a trustee with beneficiaries should not, on its own, be seen as a delegation of control to them.

From a practical perspective, this case serves as a reminder that decisions in respect of trust property should be made pursuant to proper governance procedures. Negotiations and disagreements with, and even acquiescence to requests of, beneficiaries need not jeopardize a trustee's control over a trust's affairs so long as

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the trustee is actively engaged, retains the true decision-making ability, is properly motivated, has independent authority, and is not functioning as a mere nominee. Similarly, a trustee should have the ability to gather information about proposed transactions in respect of trust property without being seen as abdicating its authority. Furthermore, a trust generally may be administered in a manner designed to minimize taxes payable, subject to legislation (including the general anti-avoidance rule in the *Income Tax Act* (Canada).

Taxpayers employing provincial tax planning strategies similar to the one employed in *Discovery Trust* should carefully review their decision-making procedures and trust documentation and ensure that central management and control factually abides in the province where the trust is intended to reside. In the meantime, more cases have been, and likely will be, heard in respect of trust residency.[4]

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1 *Discovery Trust v Minister of National Revenue*, 2015 NTLD(G) 86.

2 *Fundy Settlement v Canada*, 2012 SCC 14. The decision is alternatively known as *Garron Family Trust v R and St Michael Trust Corp v R.*

3 *Thibodeau Family Trust v Canada*, [1978] FCJ No. 607 (FCTD).

4 See, e.g., *Boettger c. Agence du revenu du Québec*, 2015 QCCQ 7517 - another recent decision dealing with the provincial residency of a trust.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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