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TAB 8

Practice Gems: Administration of Estates 2020

Estate Administration and the Secret Trust

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1. Introduction

The secret trust is a peculiar creature of law in its non-compliance with statutes such as the *Statute of Frauds*[1] and *Succession Law Reform Act*.[2] These statutes generally require contracts and testamentary instructions, respectively, to be evidenced in writing. Many secret trusts are orally created and so do not conform with written or other formality requirements. Nevertheless, courts of equity have consistently enforced secret trusts when sufficiently proven, on the basis that no statute should be used as an engine of fraud.[3] Secret trusts may be *inter vivos* or testamentary; a fully secret trust is generally seen as arising *dehors* (outside) the Will and is therefore generally considered to be non-testamentary.[4] However, courts have characterized and treated secret trusts as either testamentary or non-testamentary depending on the circumstances. The concept, creation and enforcement of a secret trust is the same regardless of the circumstances in which it is created.

This paper first reviews the elements of secret and half-secret trusts, how such trusts are proven, and the consequences that arise when such trusts fail. The paper then identifies and discusses certain issues that may arise in the course of the administration of an estate that involves a secret trust or half-secret trust.

2. Proving a Secret Trust

Secret trusts may be fully secret or half-secret. In the context of a testacy, a fully secret trust occurs where, on the face of the Will, property is transferred to a donee on absolute terms while

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1 *Statute of Frauds*, RSO 1990, c S.19, ss 1(1) and 9.

2 *Succession Law Reform Act*, RSO 1990, c S.26, ss 3 and 4(1).

3 *Blackwell v Blackwell,* [1929] AC 318 *per* Viscount Sumner at 335.

4 *Cullen v Attorney-General of Ireland* (1866), LR 1 HL 190 [*Cullen*] at 198.

trust obligations are established by the testator outside of the Will such that the donee must hold the property for the benefit of a specified beneficiary or purpose. In contrast, a half-secret trust occurs it is evident on the face of the Will that the donee is not receiving property on absolute terms, although the specific terms of the trust are communicated by the testator to the trustee outside of the Will.

In the English case of *Ottaway v Norman*,[5] the Court identified three common elements that must be proven to establish the existence of a fully or half-secret trust, and this three part test has been accepted by Canadian courts[6] for its statement of the following three part test. First, it must be shown that the testator intended for the primary donee to take the property on trust (intention). Second, this intention for a trust must have been communicated to the primary donee (communication). Third, the primary donee must have accepted or acquiesced to the trust obligations (implicit or explicit acceptance). These three criteria are discussed in more detail in the next section.

(a) Intention

In demonstrating that the testator has intended for there to be a trust, the courts will look at the wording of the Will as well as extrinsic evidence. Courts accept both oral and written extrinsic evidence.[7] As is the case when interpreting a Will, mere precatory words do not in and of themselves prove the element of intention.[8] For example, in *Hayman v Nicoll,* the testator had died leaving a will and four codicils, one of which left property to her daughter "in full confidence that she will dispose of the same in accordance with the wishes which I have expressed to her."[9] The Supreme Court of Canada was asked to determine whether the words "in full confidence" gave rise to a trust on the face of the Will. Taking into account that specific trust wording had

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5 *Ottaway v Norman* [1971], 3 All ER 1325, 2 WLR 50 at 59 [*Ottaway*].

6 See for example *Jankowski v Pelek Estate* (1995) 131 DLR (4th) 717, [1996] 2 WWR 457 (MBCA); *Champoise v Prost,* 2000 BCCA 426; *Peters v Peters Estate,* 2015 ABCA 301.

7 *Spylo v Spylo,* 2014 ONSC 3843 at para. 53; aff'd 2016 ONCA 151 [*Spylo*].

8 *Hayman v Nicoll,* [1944] SCR 253, [1944] 2 DLR [*Hayman*].

9 *Ibid*, at 256.

been included elsewhere in the Will, the Court determined that the testator had understood the trust device and that the lack of clear trust terms with respect to this particular disposition could not be interpreted as a trust.[10] As there was insufficient extrinsic evidence to otherwise show that the testator intended for there to be a trust outside of the Will, the court found that there was no secret trust.

However, precatory words can show that a secret trust was intended by the testator when the Will as a whole and the surrounding circumstances are taken into account.[11] For example, in *Jankowski v Pelek Estate*,[12] a clause in the Will of the testator transferred the residue of her estate to her executor "...to deal with as he may in his discretion decide upon." In its consideration of whether the transfer of property to the executor was an absolute gift or was intended to be held on trust, the Court remarked that while the wording in itself provided an absolute gift to the executor, the executor's evidence that he was instructed to hold the property on trust and that the testator had given specific instructions regarding the trust immediately after the Will was created was sufficient to demonstrate the testator's intention to create a secret trust.

In *Re Armstrong*,[13] the wording of the Will contained apparently contradictory language, and it was necessary for the Court to determine whether a secret trust was intended and, if so, on what terms. The relevant language in the Will read as follows:

> FOURTH. I give, devise and bequeath all my Estate, Real and personal, of whatever nature, kind and description whatsoever and wheresoever situated … to my said Executor and Trustee, but to be held by him, nevertheless, in Trust and distributed in the manner following…
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> [bequest of shares to a named individual "as his own property absolutely"]
>
> [various cash legacies to named individuals]
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> …

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10 See Donovan WM Waters, Lionel D Smith & Mark R Gillen, eds, Waters' Law of Trusts in Canada, 4th ed (Toronto: Thomson Reuters Canada Limited, 2012) at 290.

11 *Hayman*, *supra* note 8.

12 *Jankowski v Pelek Estate* (1995), 99 Man R (2d) 191, 53 ACWS (3d) 693 (MBQB); aff'd (1995), [1996] 2 WWR 457, 10 E.T.R. (2d) 117, 131 DLR 94th) 717, 107 Man. R. (2d) 167, 109 WAC 167 (Man CA).

13 *Re Armstrong* (1969), 1 NSR 1965096 58, 7 DLR (3d) 36 (NSSC) [*Armstrong*].

> SIXTH. To my twin Brother Judson Armstrong, I leave my home at Sherwood … and I direct that he dispose of the same in consultation and approval of my said Executor and Trustee, as he or they deem wise and proper.

The Nova Scotia Supreme Court considered, among other issues, whether Judson was entitled to take the devise beneficially or was required to receive the devise as trustee. The Court found that the testator had wanted to ensure that his brother Judson had a home, but wished to ultimately leave the home at Sherwood to another man, Arnold Weisner. The Court also found that the testator had communicated his wishes to the Executor and to Judson, and concluded that the testator had wanted the two of them to decide together when the property should be transferred to a Arnold. Accordingly, the Court found that Judson was not entitled to a beneficial interest in the testator's home in Sherwood by virtue of the fact that there was a secret trust not disclosed by the Will but disclosed by the testator to the Executor and Judson prior to the testator's death.

(b) Communication and Acceptance

Communication by the testator of the intention to establish a secret trust must be made to the trustee on a timely basis, and the applicable timing depends on whether the trust is secret or half-secret. In *Karsten (Deceased) v Moore*,[14] Cooke J. makes the following observation about the timing of communication of secret and half-secret trusts:

> … the decisions show that there is a distinction between cases in which, on the face of the will, the gift is to the donee as a trustee and cases in which, on the face of the will, the donee apparently takes a beneficial interest, but in which there are circumstances outside the will that give rise to a trust … In the former cases, the communication relied on must be made before, or contemporaneously with, the execution of the will, while, in the latter cases, it may be made at any time before the testator's death.[15]

Similarly, in *Ottaway,* the court dealt with a fully secret trust and stated that communication of a secret trust can be satisfied before or after the execution of the Will, provided it takes place before the testator's death.[16] This distinction in timing between fully and half-secret trusts has

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14 [1953] NZLR 456 (SC).

15 *Ibid*, at 461.

16 *Ottaway*, *supra* note 5 at 59.

been followed in Canada[17] despite controversy among academics over whether such distinction should exist.[18]

Courts accept both oral and written forms of communication and acceptance.[19] Silence of the trustee may, depending on the circumstances, constitute acquiescence and therefore acceptance of the trust duties.[20] A letter by the testator containing trust obligations may be sufficient communication for the purpose of proving a fully secret trust, provided the trustee is made aware of such a letter during the lifetime of the testator.[21] For example, in *McDonald v Moran,*[22] the testator had left a sealed letter of instructions for his executor along with his Will in a locked box. The letter provided directions regarding the distribution of his estate. After instructing the executor not to read it until after the testator's death, the testator gave the key to the box to the executor. In this case, the court found that communication and acceptance of the secret trust was valid. In circumstances where a letter of instructions was discovered after the testator's death, Courts have held that no secret trust was established because the requisite communication was not made during the testator's lifetime.[23]

(c) Other Requirements for a Secret Trust

Secret trusts must generally meet the three certainties required in all express trusts,[24] *i.e.*, certainty of intention, certainty of object and certainty of subject. In addition, a secret trust, like other trusts, may be invalid if it violates public policy. For example, the court in *Spylo* noted that

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17 See for example, *Re Mihalopulos* (1956) 5 DLR (2d) 628, 199 WWR (ns) 118; see also Albert A Oosterhoff, "Secret & Half-Secret Trusts" (2007) 26:2 ETPJ 173 at 181-185 [Oosterhoff].

18 Waters, *supra* note 10 at 296.

19 *Spylo*, *supra* note 7.

20 Waters, supra note 10 at 288; Oosterhoff, *supra* note 17 at 178.

21 Oosterhoff, *supra* note 17 at 179-80. See also *McCormick v Grogan* (1869), LR 4 HL 92 (CA Ch) and *Re Boyes* (1883), 26 Ch D 53. Both cases involve letters of instruction discovered after the testator's death. In Each case, the Court found that that there was no secret trust because the communication was not made during the testator's lifetime.

22 *McDonald v Moran* (1930), 12 MPR 424 (PEI Ch). See also *Re Boyes, ibid.*

23 See *McCormick v Grogan* (1869) [*McCormick*], LR 4 HL 92 (CA Ch) and see *Re Boyes* (1883), 26 Ch D 53.

24 Patricia A Johnson, "Secret Trusts: A Look at the Basis, Method and Consequences of Their Enforcement" (1985) 7:2 ETPJ 176 at 177. Johnson notes that if secret trusts are viewed as constructive trusts, then at minimum, secret trusts must contain certainty of subject and object.

the alleged secret trust was clearly intended to shield the alleged object of the trust from his creditors. The court in *obiter* noted that this issue, if considered, would raise the question of whether the court should "lend its aid to those who must rely upon an unlawful act in order to prove their claim."[25]

(d) Evidence

In order to establish the existence of a secret trust, the person alleging its existence bears the burden of proof on a balance of probabilities.[26] It is permitted, and in fact necessary, to use oral and written extrinsic evidence, including parol evidence, when proving the elements of a secret trust.[27] Statements of the testator made prior to, at the time of, and after the execution of the Will are permissible to determine the terms of the trust and its specified beneficiaries and to show intent (and continued intent) of the testator.[28] Corroboration may be necessary where a claim of a secret trust is brought against the estate of the alleged trustee and the only witnesses available are those with an interest in the claim.[29]

3. Consequences of a Failed Secret Trust

Where any of the elements discussed above are missing, one of several different consequences may arise depending on the circumstances. With respect to the three certainties to any express trust, if the subject matter of the secret trust is not ascertainable, then the trust will fail as no transfer of property can occur.[30] If the beneficiaries or purpose of the trust is unascertainable, a resulting trust will result.[31]

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25 *Spylo, supra* note 7 at para 95, footnote 21, citing *Nussbaum v Nussbaum,* [2004] OJ No 3763 (SCJ) at para 30.

26 *Spylo*, *ibid*.

27 *Blackwell, supra* note 3; *Jankowski, supra* note 12; and *Spylo, supra* note 7 at para. 55.

28 Hull, *ibid* at 5. And see for example, *Pring v Pring* (1689), 2 Vern 99, 23 ER 673.

29 See *Evidence Act,* RSO 1990, c E.23, s 13. See also *Hayman, supra* note 8 at 262; *Charlton v Cipperley* (1984), 12 DLR (4th) 582, 19 ETR 66 (ABCA); Oosterhoff, *supra* note 17 at 191.

30 Oosterhoff, *ibid* at 178.

31 Oosterhoff, *ibid* at 178.

Where it has not been proven that the testator intended to create a fully secret trust, the beneficiary named under the Will is generally entitled to keep the property on the basis that the Will is the expression of the testator's intent. For example, in *Spylo v Spylo*, the Ontario Superior Court of Justice found that, there being insufficient evidence of testator intent, the beneficiary named under the Will was entitled to take the property absolutely.[32] Even if testator intent has been established, courts have generally held that the donee under the Will may keep the property beneficially if the elements of communication and acceptance are not present.[33] In the case of failure of a half-secret trust, a resulting trust will arise on the basis that it is clear that the donee under the Will was not meant to have beneficial entitlement to the property.[34]

4. Estate Administration and the Secret Trust

The administration of an estate is complicated enough without layering in the complexity of a secret or half-secret trust, and the uncertainty that accompanies such a trust. This section sets out certain issues that may be encountered during the administration of an estate that involves a secret trust or half-secret trust.

(a) Trustee as Beneficiary and Attesting Witness

A threshold issue in any estate administration is whether the Will, or any gift made under it, is void. In the context of secret trusts, the issue of void gifts arises where an apparent beneficiary is also an attesting witness to the testator's Will. In Ontario, section 12 of *Succession Law Reform Act* (the "SLRA") provides that where a Will is attested by a person to whom a beneficial gift is given, the devise, bequest or other disposition is void, and provides as follows:

> 12 (1) Where a will is attested by a person to whom or to whose then spouse a beneficial devise, bequest or other disposition or appointment of or affecting property, except charges and directions for payment of debts, is thereby given or made, the devise, bequest or other disposition or appointment is void so far only as it concerns,
>
> (a) the person so attesting;
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> (b) the spouse; or

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32 *Spylo, supra* note 7 at 91. See also, for example, Hayman, *supra* note 8.

33 See for example, *McCormick*, *supra* note 23.

34 Oosterhoff, *supra* note 17 at 178.

(c) a person claiming under either of them,

but the person so attesting is a competent witness to prove the execution of the will or its validity or invalidity.

[Emphasis added]

The wording of the above-cited provision specifies that only a beneficial interest would be void. As a result, where an individual who attests a Will is named as a beneficiary in absolute terms in the Will, the gift should not be void if it can be established that the witness holds those assets on trust pursuant to a (fully) secret trust for the benefit of one or more persons, none of whom is the witness. In other jurisdictions, for example Nova Scotia, the legislation voids all gifts to a beneficiary who attests a Will and not merely beneficial gifts. However, in *Re Armstrong*,[35] the Nova Scotia Supreme Court considered the effect of a trustee of a half-secret trust attesting to the Will and concluded that the gift conferred on him an interest as trustee, in spite of the fact that he was a witness to the execution of the Will, and that the gift was only void to the extent to which he took any beneficial interest in the gift; the Court essentially read in the word "beneficial" to the relevant legislation.

In at least one case, a gift in a Will was not invalidated by a beneficiary of a half-secret trust having attested to the Will as witness, despite the fact that the statute clearly provided that a gift made to a beneficiary under the will who attests as witness is void. In *Re Young*,[36] the testator left his estate to his wife as follows:

> for her lifetime only … it being a condition of this will ... that [she] makes a new will leaving Roger Pilkington Young's estate for the purposes she knows he desires it to be used for – for the permanent aid of distressed gentlefolk and similar purposes … leaving such small legacies as she knows I wish to be paid.

The wife and a solicitor were the testator's personal representatives. The wife gave evidence that, prior to making his Will, her husband discussed with her the fact that the chauffeur should receive a legacy. the chauffeur was an attesting witness to the testator's Will. The Court considered whether the chauffeur could receive the legacy even though he was a witness to the

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35 *Re Armstrong*, *supra* note 13.

36 *Re Young,* [1951] Ch 344, [1950] 2 All ER 1245.

testator's Will, and concluded that the secret trust was created dehors (outside) the Will and, accordingly, the gift was not void.

(b) Predeceasing Beneficiary

A beneficiary of a secret trust who predeceases the testator may have a vested interest in the trust and, as such, that predeceased beneficiary's interest does not lapse.[37] For example, in Re Gardner,[38] a testator bequeathed all of her estate to her husband "knowing that he will carry out my wishes". Four days after she executed her Will the testator signed an unattested memorandum that stated in relevant part as follows:

> … the money I leave to my husband should, on his death, be equally divided among my nieces and nephew, viz., May Cunnington, Mabel Olive Hope Bayly, and Lancelot Brodrick. In the event of May Cunnington not surviving my husband then the money to be divided between M. O. H. Bayly and L. Brodrick in equal parts.

M. O. H. Bayly predeceased the testatrix who died five days later. The question before the Court in that case was whether the estate of "M. O. H. Bayly" was entitled to a one-third interest in the estate after the testator's husband had died. The testator had provided for a clear gift-over in the event of May Cunnington's death in her memorandum, but did not stipulate the same for the other two beneficiaries. The Court found that the one-third interest to which M. O. H. Bayly would have been entitled had she survived the testator was payable to her legal personal representative.

(c) Predeceasing or Disclaiming Trustee

Where a trustee has predeceased a fully secret trust, the gift lapses to the estate of the deceased.[39] However there are varying views as to the consequences of a predeceased trustee with respect to a half-secret trust. Some take the view that because the trust is clear on the face of the Will, the courts can appoint a successor trustee on the basis that a trust will not fail for want of a trustee, whereas others disagree with this view on the basis that the trustee obligation

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37 See Waters, *supra* note 10 at 310.

38 [1923] 2 Ch 230.

39 Oosterhoff, *ibid* at 176.

is personal to the individual who accepted the trust obligations, and cannot be transferred to another individual.[40]

Further, there is no consensus as to whether a trustee of a fully secret trust may disclaim his or her responsibilities as trustee. On one hand, it can be reasoned that the gift would lapse to the estate if the trustee, who on the face of the Will would take the property absolutely, chooses to disclaim the gift.[41] On the other hand, if such disclaimer was permitted, then it might amount to fraud by the trustee.[42]

(d) Payment of Debts

As noted above, a fully secret trust is generally seen as arising *dehors* (outside) the Will and is therefore generally considered to be non-testamentary. However, courts have treated secret trusts as either testamentary or non-testamentary, depending on the circumstances. Generally, for the purposes of paying off debts and liabilities, a secret trust is characterized as being testamentary in nature. For example, property administered under a probated Will is subject to the estate administration tax whether or not a secret trust is involved.[43] In addition, where estate assets are insufficient to satisfy all liabilities, distributions made under the Will must abate accordingly.[44]

An exception to the foregoing, however, is the case of *Re Maddock.*[45] In that case, the testator left the residue of her estate to a beneficiary who agreed to hold a portion of it on secret trust. However, the testator's estate was subject to significant debt and as a result, her estate abated in order to pay off the debt. The court of appeal held that the portion of the residue held

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40 Oosterhoff, *ibid* at 176.

41 *Re Maddock,* [1902] 2 Ch 220 (CA) at 231 per Cozens-Hardy LJ [*Re Maddock*].

42 *Blackwell, supra* note 3 per Lord Buckmaster at 328 and per Lord Warrington at 341.

43 Johnson, *supra* note 24 at 197. See also *Estates Administration Act*, RSO 1990, c E.22, s 5.

44 Johnson, *ibid* at 197.

45 *Re Maddock*, *supra* note 41.

personally by the beneficiary should abate before the portion held on secret trust, in order to ensure that the trustee did not benefit from his own fraud.[46]

(e) Tax Matters

Where a secret trust is established, the tax rules that apply to trusts are engaged. This means that a T3 tax return must be filed in respect of the trust. In addition, if draft legislation introduced in 2018 is passed, beginning in 2021, the trustee(s) will have to file an information return disclosing the name, address, date of birth (if applicable) and tax identification number of (i) the settlor, (ii) each trustee, (iii) each beneficiary, and (iv) if applicable, anyone with the ability to exert influence over trustee decisions (*e.g.*, a protector). The penalties associated with failure to file an information return in respect of a trust are significant (the greater of $2,500 and 5% of the highest fair market value of the assets held in the trust).

5. Concluding Remarks

While secret trusts are recognized as valid in Canada, administering an estate where there are claims of a secret trust can be complex for several reasons. Establishing the existence of a secret trust requires sufficient evidence, much of which must be produced outside of the Will, to show that the elements of intent, communication and acceptance are present. Further, where a secret trust fails, the executor must consider the facts of the case to assess how the property subject to the failed trust should be distributed. And, where a secret trust succeeds, there is a lack of consensus (and a dearth of case law) regarding the treatment and administration of such trusts. Estate trustees grappling with secret trusts are well advised to retain legal counsel equipped to advise on such issues.

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[46] Johnson, *supra* note 24 at 197. Waters, *supra* note 10 at 311.

Appendix

Case Law

Blackwell v Blackwell [1929] AC 318, [1929] UKHL 1.

Champoise v Prost, 2000 BCCA 426.

Charlton v Cipperley (1984), 12 DLR (4th) 582, 19 ETR 66 (ABCA).

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Re Armstrong (1969), 1 NSR 1965096 58, 7 DLR (3d) 36 (NSSC).

Re Boyes (1883), 26 Ch D 531.

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Re Maddock, [1902] 2 Ch 220 (CA).

Re Mihalopulos (1956) 5 DLR (2d) 628, 199 WWR (ns) 118.

Re Rees [1950] Ch 204.

Re Young, [1951] Ch 344, [1950] 2 All ER 1245.

Spylo v Spylo, 2014 ONSC 3843.

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Legislation

Estates Administration Act, RSO 1990, c E.22.

Evidence Act, RSO 1990, c E.23.

Statute of Frauds, RSO 1990, c S.19.

Succession Law Reform Act, RSO 1990, c S.26.

Wills Act, RS, c 505, s 1.

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