Powers of Appointment

Timothy Youdan
tyoudan@dwpv.com

DAVIES

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I. DEFINITION

The term "power of appointment" is sometimes used in a narrow sense under which the exercise of the power creates, or crystallizes, an interest in a trust. In this sense, it may be contrasted with a power the exercise of which causes property to be distributed out of the trust. For example, Jameson, *Ontario Succession Duties*,[1] states as follows:

> "A power of appointment is a right bestowed by an owner of property … permitting the donee of the power to direct or appoint in a certain manner an interest in property for the benefit of certain individuals."

A simple example of such a power of appointment would be in a trust where property is held for X for life and on the death of X is held on trust for such of the issue of X in such shares as X shall appoint, with a gift over in default of appointment to the issue of X in equal shares *per stirpes*.

However, the term is also used more broadly so that it includes a power to distribute property out of a trust. For example, *Anger & Honsberger's Real Property*, 2nd edition,[2] stated as follows:

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[**] Partner, Davies Ward Phillips & Vineberg LLP

[1] (1959), at 59.

[2] 2nd ed., 1985 at 476. *Cf.* the treatment of a power of encroachment as a power of appointment in tax cases: *Wanklyn* v *MNR*, [1954] Ex. C.R. 355; *Montreal Trust Co.* v *MNR*, [1955] Ex. C.R. 312.

> "A power of appointment is an authority given by one person … to another … to determine who shall receive the property that is the subject-matter of the power."

II. CLASSIFICATION

Powers, including powers of appointment have been classified for various purposes, at various times, in many different ways[3]. For the purposes of this paper, I shall set out the following brief comments on terminology provided in Hovius & Youdan, *The Law of Family Property*:[4]

> "The term "discretionary trust" is used here in a general sense, to include any trust under which benefits or property are divided or distributed on the basis of an exercise of discretion by some person or persons. Often, but not necessarily, these discretionary powers are held by the trustees as such, in which case they will be referred to as "fiduciary powers". Powers held under discretionary trusts may be classified according to the range of objects of the power. A "general power" may be exercised in favour of anyone, including the holder of the power; a "special power" may only be exercised in favour of specified persons or a defined class; and an "intermediate" or "hybrid" power may be exercised in favour of anyone except specified persons or classes of persons.
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> Powers may also be classified according to whether the holder of the power has an obligation to exercise it. If he or she does not have such an obligation, the power is referred to as a "mere power". In this case, the trust fund will be held on trust for the persons entitled "in default of" the exercise of the power. Such persons may be explicitly identified by the trust instrument. For example, property may be given to trustees on trust to divide the income or capital of the trust fund among such of the children of the settlor as the trustees may think fit and in default of exercise of the power, the capital and accumulated income is to be held on trust for the settlor's spouse. In this example, the power in favour of the children is both a special power and a fiduciary power and it is also a mere power. The spouse is the person entitled in default of appointment. In other cases of mere powers, the trust instrument may fail expressly to identify those entitled in default of appointment. In some such cases, the court may construe the trust instrument to find implied takers in default of appointment; in other cases where this is not done, there will be a resulting trust back to the settlor with respect to the interest in default of appointment. If the holder of a power has an obligation to exercise it, the

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3 See Anger & Honsberger Law of Real Property, 3rd ed. 2007 at §13.20.

4 (1991) at 262-263.

power is referred to as a "trust power". For example, property may be given to trustees on trust with a direction to divide the income and capital among the children of the settlor but subject to their discretion as to the proportions to be given to each child:

> 'A mere power involves the trustee in the making of two decisions; whether to distribute and how to distribute. If, on the other hand, the trustee has a trust power, he will be obliged to distribute the trust fund among the designated objects of the power. There will be no takers in default of appointment because no default in appointment is contemplated. A trust power involves the trustee in the making of one decision: how to distribute.'[5]

It must not be assumed, however, that a person holding a mere power has no obligation with respect to its exercise. Even a non-fiduciary holding a mere power must, of course, only exercise the power within the limits of the power. Where a power, whether a trust power or a mere power, is held by a fiduciary he or she has additional obligations: he or she must also give appropriate consideration to the exercise of the power."

III. VALIDITY: GENERAL

There is a large body of (mainly English) authority dealing with the requirements for creating a valid dispositive power under a trust. First, the terms of the power must be sufficiently certain. It appears to be established that this requirement will be satisfied,

> "if it can be said with certainty whether any given individual is or is not a member of the class [of objects of the power] and does not fail simply because it is impossible to ascertain every member of the class."[6]

In addition, although a general power is clearly valid, it appears that a trust will fail if the definition of the class of objects of a special power is such that the trust is administratively unworkable. This will occur,

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5 Hardingham & Baxt, *Discretionary Trusts*, 2nd ed, 1984 at 3-4.

6 *McPhail* v *Doulton*, [1971] A.C. 424 at 450 (H.L.). This apparently simple statement conceals a great deal of difficulty and confusion. See, *e.g.*, Emery, "The Most Hallowed Principle – Certainty of Beneficiaries of Trusts and Powers of Appointment" (1982), 98 L.Q. Rev. 551; Klinck, "McPhail v Doulton and Certainty of Objects: A 'Semantic' Criticism" (1988), 20 Ottawa L. Rev. 377.

> "where the meaning of the words used is clear but the definition of beneficiaries is so hopelessly wide as not to form anything like a class."[7]

There are cases (mainly Australian) indicating that a dispositive power provided by Will may infringe a supposed rule against delegation of will-making.[8] However, it was held by the Ontario Court of Appeal in *Re Nicholls*[9] that such a supposed rule did not affect the validity of a non-fiduciary general power of appointment. In previous English cases, both special powers and intermediate powers have been held valid, although created by will. Moreover, in *Re Beatty*,[10] Hoffman J. rejected any general rule against delegation of power by a testator. A bequest of personal chattels to trustees to distribute "among such …. persons … as they think fit and any [remaining chattels] shall fall into and become part of [the] residuary estate" was held to be a valid fiduciary power that satisfied the rules relating to certainty and was not affected by any supposed rule relating to delegation against will-making. On the other hand, the Alberta Court of Appeal, in a sparsely reasoned judgment, held in *Daniels* v. *Daniels Estate*[11] that a provision by which the testator left the residue of his estate "to my executors to distribute as they see fit" was intended to create a trust and that the trust failed for uncertainty because the objects were not ascertainable. Despite this decision of the Alberta Court of Appeal, it should be considered that the correct position is that a power of appointment that is otherwise valid will not be rendered invalid because of any rule relating to delegation against will-making. As stated by Hoffman J. in *Re Beatty*,

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7 *McPhail* v *Doulton*, [1971] A.C. 424 at 457. See *Lewin on Trusts*, 18th ed., 2008 at 101, n.43.

8 See Oosterhoff on Wills and Succession, 6th ed., 2007, at 161-169; Heydon, "Does statutory reform stultify trust law analysis?" (2008) 6 Trust Quarterly Review 11 at 12-22.

9 (1987), 25 E.T.R. 228 (Ont. C.A.).

10 [1990] 1 W.L.R. 1503 (Ch.D.)

11 [1992] 2 W.W.R. 697 (Alta C.A.). *Cf. Higginson* v *Kerr* (1889), 30 O.R. 62 (H.C.J.) (where trustees were given discretion to distribute the residue of the testator's estate, it was held that no trust for any person was created and the trustees had a general power of appointment which they could exercise in favour of themselves) and *Re Miles* (1917), 11 O.W.N. 292 (H.C.) (where executors had power to dispose of the residue "in such manner as may in their discretion seem best" it was also held that the executors had a general power of appointment which they could exercise in their own favour.)

> "a common law rule against testamentary delegation, in the sense of a restriction on the scope of testamentary powers, is a chimera, a shadow cast by the rule of certainty, having no independent existence." (at 1509).

IV. VALIDITY: RULE AGAINST PERPETUITIES

The application, at common law, of the perpetuity rule to powers of appointment can be summarized as follows:

- A special or intermediate power of appointment is void if it could be exercised outside of the perpetuity period.
- However, since a general power is treated as equivalent to absolute ownership, it is valid so long as it must be acquired within the perpetuity period.
- Even if the power is valid, an appointment made under the power may be invalid. In the case of a special power (or, probably, an intermediate power) the perpetuity period, for this purpose, begins to run from the date of the creation of the power. Since a general power is treated as equivalent to absolute ownership, the perpetuity period, for the purposes of an exercise of a general power, does not begin to run until the date of the appointment.[12]

Since the adoption of the "wait and see" rule in Ontario in 1966, the perpetuity rule is of reduced concern. The *Perpetuities Act*[13] applies, "only to instruments that take effect on or after the 6th day of September, 1966, and such instruments include an instrument made in the exercise of a general or special power of appointment on or after that date even though the instrument creating the power took effect before that date."[14] The *Perpetuities Act* explicitly deals with powers of appointment in the following provisions:

> "4(2) A limitation conferring a general power of appointment, which but for this section would have been void on the ground that it might become exercisable beyond the perpetuity period, is presumptively valid until such time, if any, as it becomes established by actual events that the power cannot be exercised within the perpetuity period.
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> 4(3) A limitation conferring any power, option or other right, other than a general power of appointment, which but for this section would have

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12 See Megarry & Wade, *The Law of Real Property*, 6th ed., 2000, at 345-348.

13 R.S.O. 1990, c.P.9.

14 Section 19.

been void on the ground that it might be exercised beyond the perpetuity period, is presumptively valid, and shall be declared or treated as void for remoteness only if, and insofar as, the right is not fully exercised within the perpetuity period.

11(1) For the purposes of the rule against perpetuities, a power of appointment shall be treated as a special power unless,

(a) in the instrument creating the power it is expressed to be exercisable by one person only; and

(b) it could, at all times during its currency when that person is of full age and capacity, be exercised by the person so as immediately to transfer to the person the whole of the interest governed by the power without the consent of any other person or compliance with any other condition, not being a formal condition relating only to the mode of exercise of the power.

(2) A power that satisfies the conditions of clauses 1(a) and (b) shall, for the purposes of the rule against perpetuities, be treated as a general power.

(3) For the purposes of determining whether an appointment made under a power of appointment exercisable by will only is void for remoteness, the power shall be treated as a general power where it would have been so treated if exercisable by deed."

V. OBLIGATIONS AFFECTING EXERCISE OF POWER

Where a power of appointment is held by a person in a fiduciary capacity, the holder of the power has a fiduciary obligation to give appropriate consideration to the exercise of the power. This is sometimes expressed by the statement that a fiduciary's exercise of discretionary power is subject to judicial intervention when it is exercised with "*mala fides*". However, this term is misleading since it is clear that an exercise of a fiduciary power may be impugned in cases where there is no conscious wrongdoing. A court will intervene if:

- The trustee achieves a result not authorized by the terms of the power.
- The trustee fails to give *bona fide* consideration to the exercise of the power.

- The trustee did not take account of relevant factors or took account of irrelevant factors.[15]

The court intervened on the basis of these principles in the *Fox Estate*[16] case in the circumstance that the trustee had taken account of her (Jewish) son's marriage to a Gentile in determining to exercise a power of encroachment in favour of her grandchildren with the consequence that her son was entirely divested of his interest in the trust. In other recent cases,[17] the courts have demonstrated a reluctance to interfere with trustees' exercise of discretion as to the selection of persons to be benefited pursuant to a power.

When the power is not held by a person in a fiduciary capacity, there is no obligation to give consideration to the exercise of the power. If the power is not exercised, the property subject to it will pass to those entitled in default of exercise of the power. Such persons will either be determined by the terms of the trust or, otherwise, the property will pass on a resulting trust. However, to be valid, even a non-fiduciary exercising a power must not achieve a result not authorized by the terms of the power. Obviously, an exercise of the power will not be valid if it is exercised outside of the express terms of the power. For example, if a person is given a power to appoint among the children of A and an appointment is made in favour of a child of B, the exercise of power will be void. However, an exercise of even a non-fiduciary power may be void even if it complies with the express terms of the power if it is exercised with an improper intent. This is called a "fraud on a power" which,

> "occurs when an appointment valid on its face is made with an intent or purpose not justified by the terms or nature of the power. Put in positive terms, an appointment must 'be a pure, straightforward, honest dedication of the property … to the person to whom [the appointor] affects, or attempts to give [the property] in that character'. Put in negative terms, the power must not be exercised for the purpose of accomplishing or carrying

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15 See Cullity, "Judicial Control of Trustees' Discretions" (1975), 25 U. of T.L.J. 99.

16 *Fox* v *Fox Estate* (1996), 10 E.T.R. (2d) 229 (Ont. C.A.).

17 *Edell* v *Sitzer* (2001), 40 E.T.R. (2d) 10 (Ont. S.C.); *Martin* v *Banting* (2001), 37 E.T.R. (2d) 270 (Ont. S.C.), appeal dismissed February 5, 2002.

> into effect any bye or sinister object (sinister in its being beyond the purpose and intent of the power)'."[18]

For example, courts have found frauds on a power to have occurred where the appointments were made with the intention of directly or indirectly benefiting the donee of the power or third persons who were not objects of the power. For example, in *Re Dick*[19] the court held that there was a fraud on a power where a testator appointed to her sister but in doing so requested that the sister provide an annuity for the family with whom the testator resided (but who were not objects of the power).

Re Dick should be compared with the recent decision of the Supreme Court of New Zealand in *Kain* v. *Hutton*.[20] A trust was established by Mr. Couper in 1981. The beneficiaries were any children of Mr. Couper, a wife of Mr. Couper, the children and grandchildren of Mr. Couper's sister and certain other trusts established by Mr. Couper. Mr. Couper married for the first time in 1989. He never had any children but his wife, Mrs. Couper, had four children. In 1999, the trustees exercised their power to distribute capital to Mr. Couper's wife by distributing certain shares to Mrs. Couper. On the same day, Mrs. Couper settled the same shares on a new discretionary trust (which had the same trustees as the 1989 trust – Mrs. Couper and two others) the beneficiaries of which were Mrs. Couper, her children and grandchildren, her siblings and their issue, her parents, the spouses or partners of any of such persons, any trust or company of which respectively any of those beneficiaries was a beneficiary or 50% shareholder and any charity. Therefore, the beneficiaries of the new trust were, except for Mrs. Couper, all persons or entities who were not beneficiaries of the 1989 trust. The plaintiffs, who were certain of the children of Mr. Couper's sister, brought proceedings claiming that the distribution to Mrs. Couper was a fraud on the power because what was sought to be achieved was to confer a benefit on non-objects of the 1989 trust, particularly Mrs. Couper's children.

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18 Anger & Honsberger Law of Real Property, 3rd ed., 2007, at §13.40.80(a).

19 [1953] Ch. 343.

20 (2008), 11 I.T.E.L.R. 130.

At first instance, the plaintiff's claim was successful since Panckhurst J. considered that the intention of the trustees of the 1989 trust "was to bring about a resettlement upon persons who were non-objects of the old trust, albeit they may not have been conscious that to do so was a fraud upon the power". The Court of Appeal disagreed. Its position, as described by the Supreme Court,[21] was that "if an appointor's purpose is to effect distribution amongst persons who are not objects of the power, the appointee merely being a conduit, the appointment cannot be supported. But . . . if the recipient has genuine freedom of action and wishes to benefit non-objects, then the exercise of the power to appoint will be upheld". The Supreme Court agreed with the Court of Appeal and affirmed the decision that there was no fraud on a power, stating as follows:

> "In any case in which it is alleged that a power has been executed excessively, whether that is said to have been done directly and openly or concealed by the use of an object of the power as a conduit, it is necessary to consider carefully whether the inclusion by one means or another of non-objects has genuinely been done for the benefit of an object of the power. Has the actuating purpose of the appointor, no matter the form of the appointment, been to benefit the object? . . .
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> The question then in the present case is whether the appointor trustees' dominant purpose in relation to the [distributed] shares was to benefit Mrs. Couper by putting her in a position where she could establish her trust as a means of benefiting herself and whether Mrs. Couper must have acted freely, regarding herself as the real recipient of the benefit. . . . [T]he Court of Appeal was quite right to hold that the plaintiffs have not shown, as they must do, that the purpose of the appointors was not to benefit Mrs. Couper but in fact to benefit her daughters and other members of her family, all of whom are admittedly non-objects of the old trust."[22]

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21 At 138.

22 At 141-142. *Cf.* the cases dealing with trustees' power to make capital payments for the "benefit" of a beneficiary holding that such payments may be made to a trust for the benefit of such beneficiary even though others will be beneficiaries of such trust. See *Lewin on Trusts*, 18th ed., 2008 at 1172-1176; *Hunter Estate* v. *Holton* (1992) 46 E.T.R. 178 (Ont. Gen. Div.).

VI. THE PRINCIPLE IN RE HASTINGS-BASS

In recent English cases, orders have been obtained invalidating an exercise of power in circumstances in which it had become apparent that the exercise of power had adverse tax consequences.[23] These cases rely on the statement of principle expressed in *Re Hastings-Bass*[24]. In that case, trustees exercised a power of appointment to create a life interest for an individual, W, with gifts over for the benefit of issue of W. The primary purpose of the trustees in exercising the power was to avoid the imposition of estate duty. It turned out that the exercise of the power contravened the rule against perpetuity with respect to the gifts over. In these circumstances, the Inland Revenue claimed that the whole exercise of power was invalid and that the effect of this was that estate duty was payable in respect of the property that was subject to the power. In proceedings brought by the trustees and in which the Inland Revenue Commissioners were the only defendants, it was held that the exercise of power was partially valid insofar as it validly created a life interest for W with the result that estate duty was not payable. In the course of coming to this decision, the following statement was made as to the applicable principle in determining whether, and to what extent, an exercise of power was vitiated by the process followed by trustees:

> "To sum up the preceding observations, in our judgment, where by the terms of a trust ... a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he has achieved is unauthorized by the power conferred upon him, or (2) it is clear that he would have not acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account."[25]

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23 *Cf.* the Canadian cases dealing with rectification. See *A.G. of Canada* v *Juliar*, [2000] D.T.C. 6589. See Smith "Can I Change My Mind? Undoing Trustee Decisions" (2008) 27 ETPJ 284.

24 [1975] Ch. 25.

25 *Ibid* at 41.

It is this principle which has been accepted in Canadian cases such as the *Fox Estate* case and which has also been relied on by the English cases, to which I shall now turn, dealing with the effect of unforeseen tax consequences.

Green v. *Cobham*[26] concerned an application brought by the trustees which was supported by all of the defendant beneficiaries. The trustees sought an order that an appointment made pursuant to the terms of a testamentary trust was void since the appointment would have capital gains tax consequences which Parker J. characterized as "catastrophic". The trustees had not considered these consequences at the time of making the appointment. Parker J. stated as follows:[27]

> "I ... conclude that this is a clear case for the application of the *Hastings-Bass* principle. In my judgment there is no real room for doubt on the evidence that had the then trustees of the will trust had regard to the possible capital gains tax consequences of the proposed appointment in favour of [the intended beneficiary], they would not – and I stress would not – have gone ahead with it. What other course they might have taken is, I accept, not entirely clear. However, what is entirely clear ... is that had the trustees directed their minds, as they should have done, to considerations of capital gains tax, they would not under any circumstances have made an appointment which gave rise to any significant risk that the will trust might thereafter become a United Kingdom resident trust for capital gains tax purposes ....
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> In these circumstances it follows ... that the principle in *Re Hastings-Bass* applies in this case, and that the application of that principle requires that the court should interfere by declaring the 1990 deed to be an invalid exercise of a trustee's power of appointment, and consequently void in its entirety ...."

Abacus Trust Co. v. *NSPCC*[28] is to similar effect. A power of appointment was exercised as part of an arrangement designed to avoid United Kingdom capital gains tax. The trustees had been advised by counsel that the appointment should not be exercised during a tax year in which the settlor and his family continued to be beneficiaries of the trust. The tax year in question ended on April 5, 1998. In

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26 (2000), 4 I.T.E.L.R. 784 (Eng. Ch. D.).

27 *Ibid* at 795-796.

28 (2001), 3 I.T.E.L.R. 846 (Eng. Ch. D.).

implementing the proposed arrangements, the trustees overlooked this advice of counsel and the executed documentation had the effect that the settlor and his family were excluded from the trust as beneficiaries on April 3, 1998 and on the same day – and therefore within the same tax year – the power of appointment was exercised in favour of the NSPCC. Patten J. applied *Green* v. *Cobham* and the *Hastings-Bass* principle. He stated[29] as follows:

> "That decision [Green v Cobham] is clear authority that trustees, when exercising powers of appointment, are bound to have regard to the fiscal consequences of their actions and that where it can be demonstrated that a proper consideration of these matters would have led to the appointment not going ahead the court is entitled to and should treat that as an invalid exercise of power in the sense of it being void ab initio. Although the time may yet come when the limits of the *Hastings-Bass* principle fall to be determined by some higher court I can see no reason on the authorities as they stand for not following the decision of Jonathan Parker J. in *Green* v *Cobham*. The financial consequences for the beneficiaries of any intended exercise of a fiduciary power cannot be assessed without reference to their fiscal implications. The two seem to me inseparable. Therefore if the effect of an intended appointment is likely to expose the fund or its beneficiaries to a significant charge to tax that is something which the trustees have an obligation to consider when deciding whether it is proper to proceed with the appointment. Once relevance is established then a failure to take these matters into account must vitiate the exercise of the power unless (as in *Hastings-Bass* itself) it is clear that on a proper consideration of all relevant matters the decision would still have been the same."

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[29] *Ibid* at 859. The cases are not completely consistent in their formulations of the standard of proof regarding the likelihood that the improper consideration affected the decision making. *Re Hastings-Barr* and *Mettoy Pension Trustees Ltd.* v *Evans* [1990] itself 1 W.L.R. 1587 at 1621 indicate that a requirement that the trustees "could" have made a different decision whereas *Stannard* v *Fisons Pension Trust Ltd.* [1991] P.L.R. 225 (CA) indicates that it is sufficient that the decision "might" have been different. See the discussion of this point in *Abacus Trust Co. (Isle of Man)* v *Barr* [2003] Ch. 409 at 416-417; *Burrell* v *Burrell (2005)*, 7 I.T.E.L.R. 622 at 635, and *Sieff* v *Fox* [2005] 3 All E.R. 693 at 717. In the latter case, Lloyd L.J. stated:

> > *"It seems to me that, for the purposes of a case where the trustees are not under a duty to act, the relevant test is still that stated in* Re Hastings-Bass, *namely whether, if they had not misunderstood the effect that their actual exercise of the discretionary power would have, they* would *have acted differently. Only in a case where the beneficiary is entitled to require the trustees to act … should it suffice to vitiate the trustees' decision to show that they* might *have acted differently."*

Since the trustees in the *Abacus Trust Co.* case had not taken account of the capital gains tax consequences of making the appointment in the same tax year that the settlor and his family remained beneficiaries of the trust and it was clear that the trustees would not have acted as they did had they been aware of the financial consequences of their acts, it was held that the appointment was "invalid and of no effect".

An additional requirement for the application of the *Hastings-Bass* principle was apparently introduced by Lightman J. in *Abacus Trust Co. (Isle of Man)* v *Barr*.[30] In that case, the trustee had a power of appointment exercisable, with the consent of the Protector, in favour of certain discretionary beneficiaries, including the settlor's children. The settlor wished the trustee to exercise this power in respect of 40% of the trust fund for the benefit of the settlor's two sons. He asked the trustee's representative to inform the trustee of his wishes. The trustee's representative misunderstood or misinterpreted the settlor's instructions and informed the trustee and the trustee's solicitors that the settlor wished the trustee to appoint 60% of the trust fund. The trustee and protector consequently executed a deed of appointment to this effect. Lightman J., in proceedings brought nine years after the execution of the deed of appointment, held that the appointment was voidable. In the course of his judgement, Lightman J. stated[31] as follows:

> "In my view it is not sufficient to bring the rule into play that the trustee made a mistake or by reason of ignorance or a mistake did not take into account a relevant consideration or took into account an irrelevant consideration. What has to be established is that the trustee in making his decision has … failed to consider what he was under a duty to consider. If the trustee has in accordance with his duty identified the relevant considerations and used all proper care and diligence in obtaining the relevant information and advice relating to these considerations, the trustee can be in no breach of duty and its decision cannot be impugned merely because in fact that information turns out to be partial or incorrect …

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30 [2003] Ch. 409.

31 At 417-418.

> In summary the rule affords to the beneficiaries the protection of a requirement that the trustee performs its duty in exercising of its discretion, and a remedy in case of a default. In the absence of any such breach of duty the rule does not afford the right to the trustee or any beneficiary to have a decision declared invalid because the trustee's decision was in some way mistaken or has unforeseen and unpalatable consequences."

On the facts of this case, Lightman J. held that the trustee was in breach of duty since,

> "[t]he trustee failed to take adequate measures to ensure that it received a consent rather than a garbled version of the settlor's wishes. [The representative of the trustee] was under the set-up in operation its appointed vehicle for the eliciting and transmitting of the settlor's wishes to the trustee."[32]

Lightman J. further held, as indicated above, that an appointment that, in accordance with the rule in *Hastings-Bass*, is improperly made is voidable and not void. Consequently, the court has a discretion whether or not to set aside the appointment. Such matters as delay and acquiescence would be relevant to such exercise of discretion.[33]

In *Burrell* v *Burrell*,[34] trustees took account of the tax consequences of the exercise by them of a power of appointment but they failed to consider a relevant consideration with the result that part of the exercise of the power gave rise to a substantial liability to inheritance tax. The trustees would not have exercised the power in the way they did if they had adverted to this tax consequence. Mann J. held that the part of the exercise of the power that attracted the unforeseen tax consequences should be set aside. He pointed out that the decision of Lightman J. in *Abacus Trust Co. (Isle of Man)* v *Barr* "might be said to introduce an additional requirement of a breach of duty or default on the part of the trustee or on the part of its advisers or agents if the principle in

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32 At 419.

33 See the discussion of this point in *Sieff* v *Fox* [2005] 3 All E.R. 693 at 717-719.

34 (2005), 7 I.T.E.L.R. 622 (Ch. D.).

Hastings-Bass is to be invoked."[35] He decided, however, that it was not necessary for him to decide the correctness of Lightman J.'s position. Even applying the modified test propounded by Lightman J., the principle was satisfied since both the trustees and their advisers were in breach of duty when they were considering the deed of appointment.

In *Breadner* v *Granville-Grossman*,[36] Park J. refused to extend the *Hastings-Bass* principle to order that something should be treated as done which it was argued the Trustees would have done if they had taken account of relevant considerations. The problem was that trustees who had a mere power exercisable within a certain time period purported to exercise it the day after the expiry of the time period, in consequence of which trusts in default of appointment took effect. It was argued that the trustees should be directed to hold the trust fund "on trusts reflecting those intended to be created" by the belated deed. Park J. declined to do this, stating[37] as follows:

> "The [*Hastings-Bass*] principle is still in an early stage of development and the limits to it have not been established. There must surely be some limits. It cannot be right that whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place. Further, there is no reported decision (nor, as far as I know, unreported decision) in which the principle has been applied so as to take away beneficial interests from the persons who are properly entitled to them under the trust instruments.
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> So far as the present case is concerned, the most important point about the *Hastings-Bass* principle is that it has been developed and explained as a principle whereby the courts will hold to have been ineffective something which the trustees have done.
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> In my judgment … there is a very big difference between, on the one hand, the courts declaring something which the trustees have done to be void, and on the other hand, the courts holding that a trust takes effect as if the trustees had done something which they never did at all. It is a big step from *In re Hastings-Bass*, not a small one, and I am not willing to take it, especially when I would be changing the beneficial interests and

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35 *Ibid* at 637. *Cf Sieff* v *Fox* [2005] 3 All E.R. 693 at 718 where Lloyd L.J. doubted whether "the application of the doctrine should be regarded as depending on a breach of duty, and whether its consequences should be aligned with those of a breach of trust".

36 [1992] 2 W.L.R. 2 (Ch. D.).

37 *Ibid* at 611.

> depriving the cousins [*i.e.*, those entitled in default of appointment] of what I consider to be their property …"

The applicable principles and relevant authorities were exhaustively reviewed by Lloyd L.J. (sitting as a judge of the Chancery Division) in *Sieff* v. *Fox*.[38] Among other points, Lloyd L.J. rejected the argument that, for the *Hastings-Bass* principle to apply, "it is not enough … that the trustees be mistaken as to the fiscal effects of the transaction, and that the mistake must be as to the substantive legal effect of the appointment or other act … or as to a matter of fact …", stating that he had no doubt that, "fiscal consequences may be relevant considerations which the trustees ought to take into account, and that a material difference between the intended and actual fiscal consequences of the act may be sufficient to bring the principle into play."[39]

VII. SCOPE OF THE POWER

Various issues – which are essentially issues of construction – can arise about the scope of a power of appointment. For example, it can be a difficult question whether the power of appointment requires, or permits, a continuation of the existing trust with the same trustees continuing to act in respect of the appointed property or whether it requires, or permits, the establishment of a new, separate trust of the appointed property, with trustees different from the trustees of the original trust. *Re Moffat*[40] provides an illustration of this problem. In that case, a trust conferred a power of appointment on the testator's wife in the following terms:

> "From and after the death of my wife to dispose of the income and the capital of my estate among my said son Malcolm, his wife and his child or children or some or all of them at such time and in such manner as my said wife may by her Last Will and Testament appoint."

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38 [2005] 3 All E.R. 693.

39 *Ibid* at 719, 720.

40 [1950] 4 D.L.R. 630 (Ont. H.C.). *Cf.* the English tax cases dealing with the question whether, for capital gains tax purposes, an exercise of power created a new, separate settlement. See *Roome* v *Edwards* [1982] A.C. 279 (H.L.); *Bond* v *Pickford* [1983] S.T.C. 517 (C.A.); and *Swires* v *Renton* [1991] S.T.C. 490.

The testator's wife, by her Will, exercised the power by requiring the balance of the testator's estate to be transferred to different trustees from the trustees of the testator's Will subject to certain detailed trust provisions including wide discretionary powers. After a detailed and careful review of the relevant authorities, McRuer C.J. stated[41] that the applicable principle, which he derived from the *Restatement of the Law of Property*, was as follows:

> "[I]t is the essence of a power of appointment that the donee has the same breadth of discretion in the exercise of the power that the donor would have over the disposition of his own property, subject to any restrictions expressed or to be implied from the language used in the instrument creating the power. Where the power is limited to a class the breadth of the discretion to be exercised is determined by the limitations of the class and in the absence of a contrary intention expressed or to be implied from the language used in the instrument creating the power, the donee may exercise for the benefit of the members of the class all the powers that the donor might have exercised in the disposition of his own property."

On the basis of this principle, McRuer C.J. held that it was open to the wife to appoint trustees of the appointed property different from those who were the trustees of the testator's estate.

A power given to a named person in his or her individual capacity, in the absence of contrary provision, may only be exercised by that individual. On the other hand, a power given to a person in the capacity of trustee is *prima facie* given *ex officio* and, in the absence of contrary provision, may be exercised by successors as trustees.

In general, a person to whom a power of appointment has been given may not delegate the exercise of the power to another: *delegatus non potest delegare*. On the basis of this principle, it is generally considered that, in the absence of express provision to the contrary in the relevant instrument, the fiduciary holder of a special power or intermediate power may not make an appointment on discretionary trusts. This was the position taken by Megarry V.-C. in *Re Hay's Settlement Trust*.[42] In that case, the trustees

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41 *Ibid* at 645-646.

42 [1981] 1 All E.R. 786 (Ch. D.).

had power to appoint to "such persons or purposes" as they should, by deed within 21 years of the date of the settlement, in their discretion select except the settlor, her husband or the trustees themselves. The trustees purported to exercise the power by appointing the whole of the trust fund to be held by themselves on a similar trust to that created by the settlement but with a wider class of beneficiaries entitled to undisposed-of income and with a provision for the trust to continue for a longer period. It was held that the exercise of the power was invalid since the settlement had conferred a power to select particular persons and purposes, and the purported exercise of the power had not done that. Instead, it created a mechanism for making such selections later.

It appears that greater latitude will be allowed where the power is held by a non-fiduciary. In *Re Triffit's Settlement,*[43] a trust conferred a power of appointment on the settlor in favour of:

> "Such person or persons other than and except [the settlor's father] and any wife of his and in such manner generally as the [settlor] shall from time to time or at any time by deed revocable or irrevocable with the consent in writing of the trustees for the time being … appoint."

The settlor wished to exercise the power by execution of a deed settling certain of the trust property:

> "Upon trust for … [certain defined classes of] beneficiaries or any one or more of them exclusive of the other or others in such shares and proportions and subject to such terms limitations and provisions as the trustees shall from time to time without offending the rule against perpetuities by deed or deeds revocable or irrevocable execute before the vesting day."

The vesting day was defined in the deed as a day to expire at the end of 21 years from the date of the original trust. The trustees of the appointed property would not be the same body as the trustees of the original trust.

The settlor sought a declaration that the deed would constitute a valid exercise of the power. Upjohn J. stated[44] the applicable principles as follows:

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[43] [1958] Ch. 852.

> "The donee of the power can delegate the exercise of discretionary powers to others in two cases: First, where there is a completely general power in its widest sense, that is tantamount to ownership, and, therefore, the donee of the power can exercise it in whatever way he pleases[45] … . Secondly, the donee may delegate discretionary powers where, as a matter of construction, some power can be spelt out enabling the donee of the power to delegate his discretion … . In all other cases the principle "delegatus non potest delegare" applies."

Upjohn J. pointed out that since the power was a non-fiduciary power conferred upon the settlor for her own benefit and was widely drawn so that, subject only to the exclusions of two persons and subject to obtaining the consent of the trustees, she could appoint to anyone in the world. In these circumstances, he held that it was implied in the power that she could entirely delegate the exercise of discretionary powers.

Both *Re Moffat* and *Re Hay* illustrate the importance of provisions conferring powers of appointment being drafted with great care. In particular, the provisions should make it clear whether new trusts can apply to the appointed property and, in such a case, whether the trustees of such new trusts may or may not be different from the trustees of the original settlement, and whether there may be discretionary trusts and powers affecting the appointed property.

VIII. FORMALITIES FOR EXERCISE OF POWERS

Section 9 of the *Succession Law Reform Act*[46] provides that, where a power is exercisable by Will, the formalities for execution and attestation for such exercise are those provided by the *Succession Law Reform Act* in respect of Wills notwithstanding any other requirement purportedly provided by the instrument creating the power.

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44 *Ibid* at 861.

45 *Cf. Smith* v *Chishome* (1888), 15 O.A.R. 738, where a person had a general power to appoint the uses of real property by his will or by deed and it was held that he could not delegate the power by will.

46 R.S.O. 1990, c. S.26.

Similarly, section 25 of the *Conveyancing and Law of Property Act*[47] provides that a deed executed in the presence of and attested by two or more witnesses in the manner in which deeds are ordinarily executed and attested is a valid execution of an *inter vivos* power as regards execution and attestation, even though some additional or other form of execution or attestation or solemnity is required by the terms of the power. However, it is rare for a power to require formalities for execution beyond those ordinarily required for a Will (in the case of a power exercisable by a Will) or for a deed (in the case of a power exercisable by deed) and, consequently, these provisions are rarely of importance. It should also be emphasized that these provisions of the *Succession Law Reform Act* and the *Conveyancing and Law of Property Act* do not mandate that a power of appointment must be exercised by Will or deed. A power of appointment exercised *inter vivos* may well provide for exercise by, for example, any written instrument without any requirement that the instrument be a deed.

Section 25 of the *Succession Law Reform Act* has the effect that, except when a contrary intention appears by the Will, a generally expressed devise or bequest of property by Will will be effective to exercise a general power of appointment. Also, it is common for Wills expressly to refer to general powers of appointment with wording such as the following:

> "I GIVE, DEVISE AND BEQUEATH all my property of every nature and kind wheresoever situate, including any property over which I may have a general power of appointment, to my Trustees upon the following trusts, namely: ...."

In order to preclude the risk that a person may exercise a power inadvertently, it may be considered appropriate to provide in the instrument creating the power that the instrument exercising the power shall expressly refer to the instrument creating the power.

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47 R.S.O. 1990, c.C.

IX. POWERS OF APPOINTMENT IN ADMINISTRATION OF ESTATES

As mentioned above, a general power of appointment is treated as equivalent to absolute ownership for the purposes of the operation of the rule against perpetuities. Similarly, a general power of appointment is treated for certain purposes as equivalent to ownership in the context of devolution of property on death.

At common law, neither real property nor personal property appointed on death pursuant to a general power of appointment vested in the personal representatives of the appointor. Nevertheless, equity developed a principle under which:

> "property, real or personal, comprised in a general power of appointment exercised by will, or by a deed not operating to transfer the property to the appointee during the lifetime of the appointor, was available, in default of other assets, for the payment of the appointor's debts."[48]

This principle has been partly codified by section 54 of the *Trustee Act*[49] which provides as follows:

> "property over which a deceased person had a general power of appointment, which he or she might have exercised for his or her own benefit without the assent of any other person, shall be assets for the payment of his or her debts where the same is appointed by will, and, under an execution against the personal representatives of such deceased person, such assets may be seized and sold after the deceased person's own property has been exhausted."

In addition, section 2(2) of the *Estates Administration Act*[50] has the effect that property subject to a general power of appointment exercised by Will becomes vested in the personal representatives of the person exercising the power.

Neither of these statutory provisions extends to a general power of appointment exercised by deed taking effect after the appointor's death. Nevertheless, it appears that the equitable principle described above would continue to apply in such a

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48 Williams, Mortimer & Sunnucks, *Executors Administrators and Probate*, 18th ed., 2000, at 605.

49 R.S.O. 1990, c.T. 23.

50 R.S.O. 1990, c.E 22.

case. It should also be noted that the equitable principle and section 54 of the *Trustee Act* only make the property subject to the general power available to the creditors of the deceased appointor when, in the words of the statutory provision, "the deceased person's own property has been exhausted." On the other hand, section 2(2) of the *Estates Administration Act* has the effect that section 2 of the Act applies as if the property subject to the power were "property vested in" the appointor and section 2(1) provides that such property,

> "devolves to and becomes vested in his or her personal representative from time to time as trustee for the persons by law beneficially entitled thereto, and, subject to the payment of the person's debts and so far as such property is not disposed of by deed, will, contract or other effectual disposition, it shall be administered, dealt with and distributed as if it were personal property not so disposed of."

It is, therefore, unclear whether, pursuant to section 2 of the *Estates Administration Act*, property subject to a general power exercised by Will is treated for all purposes as assets available for the payment of creditors of the appointor or whether, pursuant to section 54 of the *Trustee Act*, such property is only available for the payment of the creditors to the extent that "the deceased person's own property has been exhausted."

X. INCOME TAX ISSUES

The starting-point is that the holder of a power, as such, does not, under the general law, own property. "'A power' is an individual personal capacity of the donee of the power to do something."[51] It is the well-established position that such a personal capacity does not amount to the ownership of property.

Maurice Cullity, in the Canadian Tax Foundation, *Report of Proceedings of the Twenty-Eighth Tax Conference 1976*,[52] considered whether the holding of a power of appointment could be considered property of the holder of the power for the purposes

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[51] *Ex p. Gilchrist* (1886), 17 QBD 521 at 531 (CA). However, the property of a bankrupt divisible among the creditors includes "such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit": *Bankruptcy and Insolvency Act*, RSC 1985, c B.3, s.67(1)(d).

[52] At 749.

of the deemed realization on his or her death. After referring to the conventional position referred to in the preceding paragraph, Mr. Cullity referred to the statement of Dickson, J. in *Minister of Revenue Ontario* v. *McCreath*[53] that,

> "The niceties and arcana of ancient property law should [not] be fastened upon with mechanical rigidity to determine the effect of a modern taxation statute whose purpose is plain."

Mr. Cullity continued as follows:[54]

> "In the light of that statement, the wide definition of the term 'property' in the *Income Tax Act* ("… a right of any kind whatever …") and the current attitude of the judiciary to the interpretation and application of the provisions of the statute, it is possible that, in income tax law, the property lawyer's distinction between holding a power and owning property might not be adhered to. The question is, perhaps, most likely to arise in a situation where a life tenant who is not a trustee has a general power of appointment over capital or an unrestricted power of encroachment. In each such case the donee of the power would be in a position substantially equivalent to that of an owner of the corpus of the trust, and it is possible that a court would hold that he was the owner of the corpus for the purpose of the deemed realization immediately prior to the death. Such a conclusion would depart from fundamental proprietary concepts and would require a similarly broad interpretation of paragraph 70(5)(c) if the realization is to produce a step up in costs for the successors to the property. There should be no similar problem with the traditional special power of appointment in favour of children or issue with a gift in default to the children in equal shares."

Mr. Cullity also considered whether the exercise of a power might be considered a disposition for the purposes of the *Income Tax Act*. It had been held by courts in the United States that the exercise of a power of appointment by a person with an income interest that is terminated on the exercise of the power does not amount to a gift for gift tax purposes by such holder of the power. Nevertheless, Mr. Cullity considered that where a person with a general power of appointment also has an interest in the property that will be affected by an exercise of the power, "the exercise of the

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53 (1976), 67 DLR (3d) 449 at 461 (SCC).

54 At 749.

general power should be regarded as a disposition for the purposes of a realization of capital gains or capital losses".[55] He then continued[56] as follows:

> "Where the donee of a special power of appointment has no beneficial interest which will be affected by an exercise of the power, I believe there should be more room for an application of the traditional theory that the exercise has merely completed the original disposition by the person who created the power. No property passes from the donee in such a case and I do not believe that it would be treated as a disposition. Similarly, I think it is improbable that an exercise of a power by a trustee who cannot appoint to himself would be regarded as a disposition although a transfer or distribution pursuant to the exercise of the power would be so treated. In the latter case the property would roll out at its cost to the beneficiary unless the trust was a spouse trust and the distribution occurred in the spouse's lifetime."

General powers of appointment were considered by the English Court of Appeal in *Melville* v. *I.R.C.*[57] The case dealt with complicated issues relating to United Kingdom Inheritance Tax and the effect of the actual decision has been reversed by legislation. Nevertheless, the case has potential relevance to the Canadian *Income Tax Act* and, as I shall mention below, it has been relied on by CRA in a recent technical interpretation. The question in the *Melville* case was whether a general power of appointment was property for the purposes of the applicable legislation. It was accepted by counsel for both sides that a power is ordinarily not property. However, the relevant United Kingdom legislation included a provision, section 272, which provided as follows:

> "In this Act, except where the context otherwise requires –
>
> 'property' includes rights and interests of any description."

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55 At 750.

56 Ibid.

57 [2001] BTC 8039.

It was held that section 272 had the effect that a general power of appointment was property for the purposes of the legislation unless the context required otherwise. Gibson, L.J. stated as follows:[58]

> "The holder of a general power of appointment (in contrast with the holder of a special power which he cannot exercise in his own favour) unquestionably has a valuable right, the value of which must be taken into account in the value of the holder's estate … unless excluded by some provision of the Act."

Although treatment of the power as property had the effect of creating potential double taxation, it was held that the relevant legislation did not "otherwise require" and that the power of appointment was property for the purposes of the legislation.

A CRA technical interpretation dated October 3, 2000[59] dealt with the question whether a "limited power of appointment" exercisable by the will of an individual would be capital property of the individual for the purposes of the deemed disposition on the death of the individual under section 70(5) of the Act. The class of objects of the power consisted of the individual's spouse, children and siblings as well as organizations that qualified as charities under the laws of the United States. CRA stated as follows:

> "In our opinion, a power of appointment is not, in itself, property and thus is not subject to the deemed disposition rules in subsection 70(5). However, a power of appointment in respect of property held by a trust may affect the value of any interest in that trust that is held by the person who holds the power of appointment particularly when no other person is entitled to any of the income or capital of the trust prior to that person's death. Depending on the circumstances, the value of the capital interest in the trust may equal the value of the trust's assets at the time that the capital interest is being valued. Nevertheless, the valuation of an interest in a trust involves an analysis of all the relevant information and the exercise of judgment in determining the appropriate method of valuing such an interest. As a result, the CCRA is unable to provide or confirm the

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58 *Ibid* at 8048.

59 Document No. 2000-001323.

> validity of any particular valuation used in the determination of the fair market value of any particular property."

A technical interpretation dated November 12, 2002 dealt with the question how a general power of appointment is treated upon the death of the holder of the power. In her response, the CRA officer referred to both the Maurice Cullity article referred to above and the *Melville* case. She stated that she was assuming that the power in question was not held in a fiduciary capacity and she then stated as follows:

> "A power of appointment … is generally not considered property in itself, and thus is generally not subject to the deemed disposition rules in subsection 70(5). However, a power of appointment in respect of property held by a trust may affect the value of any interest in that trust that is held by the person who holds the power of appointment. Where the power of appointment can be exercised in favour of the holder but the holder doesn't otherwise hold an interest in the trust, the holder would likely be considered to have a beneficial interest in the trust under subsection 248(25). The valuation of an interest in a trust involves an analysis of all the relevant information and the exercise of judgment in determining the appropriate method of valuing such an interest. As a result, the CCRA is unable to provide or confirm the validity of any particular valuation used in the determination of the fair market value of any particular property."

A recent technical interpretation[60] deals with the question whether there would be a deemed disposition of property when a person who holds a general power of appointment over trust property which is not taxable Canadian property becomes resident in Canada. The response provided was as follows:

> "It is the position of the CRA that a power of appointment is not property in itself and thus is not subject to the deemed disposition rules in subsection 70(5) of the Act. For the same reason, the deemed disposition rules in paragraph 128.1(1)(b) of the Act would not apply to a power of appointment that was held by a person immediately before he or she immigrates to Canada. However, a power of appointment in respect of property held by a trust may affect the value of any interest in that trust that is held by the person who holds the power of appointment. Where the power of appointment can be exercised in favour of the holder but the holder does not otherwise hold an interest in the trust, the holder would likely be considered to have a beneficial interest in the trust under

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[60] Document No. 2008-0280781E5.

> paragraph 248(25)(b) of the Act. In such a case, the deemed disposition rules in paragraph 128.1(1)(b) of the Act would apply with respect to the interest in the trust of the holder/immigrant.
>
> The valuation of an interest in a trust involves an analysis of all the relevant information relating to the circumstances of a particular situation (including, in this case, the terms of the power of appointment) and the exercise of judgment in determining the appropriate method of valuing such an interest. As a result, the CRA is unable to provide the method or confirm the validity of any particular valuation used in the determination of the fair market value of any such property. The cost of a holder's capital interest in a personal trust is determined under subsection 107(1) of the Act."

If a power of appointment, or other significant power over the property of the trust such as a power to revoke or a power of encroachment, is treated as a capital property, or as increasing the value of the interest in the trust of the holder of the power, there appears to be a risk of double taxation.[61] Tax will be payable on the deemed disposition on the death of the holder of the power in respect of the power or the holder's interest in the trust property, but it seems that this would not generally cause an increase to the adjusted cost base of the property in the trust. There is no such possibility of double taxation in the case of alter ego trusts, spousal or common-law partner trusts and joint spousal or common-law partner trusts since the definition of "cost amount" of a capital interest[62] in such a trust has the effect that the cost amount of the capital interest of the creator of the trust in the case of an alter ego trust or of the partner of the creator of the trust, in the case of a spousal or common-law partner trust, or of the survivor of the creator of the trust and his or her partner, in the case of a joint spousal or common-law partner trust, is adjusted to take account of the deemed disposition of the property of the trust under section 104(4).

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61 See *Goodman on Estate Planning* (2002), Vol. X, No. 4 at 834.

62 Section 108(1) "cost amount" (a.i).