Federal Court of Appeal decision in the Garron Family Trust case: How the residency of a trust is determined

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On November 17, 2010, the long awaited decision was released by the Federal Court of Appeal ("FCA") in *St. Michael Trust Corp. as Trustee of the Fundy Settlement v. Her Majesty The Queen* and *St. Michael Trust Corp., as Trustee of the Summersby Settlement v. Her Majesty The Queen* ("*Garron Family Trust*").

In its lengthy reasons, the FCA determined that the Tax Court of Canada decision, as outlined in our September 16, 2009 blog, was substantially correct. In particular, the FCA stated *"…. that where a question arises as to the residence of a trust for tax purposes, it is appropriate to undertake a fact driven analysis with a view to determining the place where the central management and control of the trust is actually exercised."* [See paragraph 62 of the decision]

Accordingly, the FCA has stated, quite strongly, that the central management and control test is the appropriate one to utilize when determining the residence of a trust for tax purposes. The FCA also stated that it is certainly appropriate for trustees to delegate certain of their responsibilities and retain others for advice. However, at paragraph 68 of the decision, the FCA states the following:

"[68] However, there is a line to be drawn. On one side of the line are recommendations, even strong ones, by the beneficiaries to the trustee, leaving the trustee free to decide how to exercise the powers and discretions under the trust. In that case, the trustee is still managing and controlling the trust. On the other side of the line the beneficiaries are really exercising the powers and discretions under the trusts, managing and controlling the trusts, and displacing the appointed trustee. As mentioned above, on which side of the line a case falls is a factual question, requiring consideration of the evidence in its totality."

The above paragraph, in my view, is particularly enlightening and trustees will need to be very careful into the future in order to ensure that the residence of a trust is truly where they intend it to be.

The FCA, unlike the Tax Court, found that section 94 of the *Income Tax Act* applied to the facts of the case which would therefore have caused the non-resident trusts to be deemed resident in Canada. The issue at stake was whether or not the so called "contribution test" of section 94 was met if the non-resident trusts in question acquired property "directly or indirectly in any manner whatever" from a Canadian resident beneficiary. Based upon the facts of the case, the Court found that there had in fact been a shift in value from the Canadian resident shareholders to the non-resident trusts at the time the particular transaction occurred to insert the non-resident trusts into the shareholdings of the subject Canadian corporations. The section 94 analysis by the FCA will surely attract the attention of many tax advisors who deal with section 94 on a regular and routine basis.

This decision will no doubt capture the attention of the tax community. Tax advisors and their clients who utilize trusts as a flexible tool for tax and estate planning will need to carefully consider this decision into the future. It will also be interesting to see how this decision attracts the attention of the international

tax community given that the community has been anxiously waiting for the FCA's comments. It will further be interesting to see whether or not the taxpayer seeks leave to the Supreme Court of Canada. Stay tuned… these are interesting times and it is likely that this is not the end of the story.