

The Interface Between Trust Law and Bankruptcy and Insolvency Regimes

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The Constitution in the Insolvency Tool Box

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INTRODUCTION

A beneficiary of property held in trust by an insolvent person has “priority” with respect to that property over the claims of the creditors of the person under both provincial and federal law. Generally the term “priority” is used to describe a hierarchy of claims to a particular asset owned by a common debtor. In the context of this paper, the term refers to the relative interest of a trust beneficiary and the creditors of the insolvent trustee.¹ It is trite law that trust property the title to which is held by an insolvent person as trustee for the benefit of someone else is not property that is available to satisfy claims of the trustee’s creditors. It is not part of a bankrupt trustee’s estate² and is not property subject to a plan of reorganization under insolvency systems. While the trustee may hold legal title to the trust property, he or she does not hold the beneficial interest in it; in equity, the property, including traceable proceeds, belong to the beneficiaries. However, like most other obvious principles of law, this principle cannot be applied without qualifications and in disregard of the policy implications of doing so in some contexts.

Trusts are a very important and widely-used feature of modern law. They come in many forms and their use and recognition have important commercial and social effects. However, not all trusts are created in the same way or for the same reason. Some are created by deed or contract; some are recognized by equity as being implicit in certain relationships; some are created by statute and some are created or declared *ex post facto* by courts in exercise of their equitable jurisdiction. Beneficiaries vary in kind. Some fall into the traditional categories of beneficiaries recognized in equity; some are governments seeking to enforce tax or other obligations; some are persons whom legislatures have decided should not be treated as ordinary unsecured creditors and some are victims of unjust conduct.

As might be expected, given the many kinds of trusts that exist and the interests affected by them, the interface between trust law, on the one hand, and bankruptcy and insolvency law, on the other, has generated both legislation and litigation. An aspect of this interface is the constitutional division of power: trust law is a matter of property and civil rights that falls within provincial legislative jurisdiction;³ while bankruptcy and formal insolvency structures are matters within the legislative

¹ This is not to say that the issue of priority does not arise in the context of trusts. When the trustee transfer legal title (or its equivalent) to a good faith transferee, including a secured creditor, the interest transferred is given priority over the interest of the beneficiary. See *I Trade Finance Inc v Bank of Montreal*, [2011] 2 SCR 360, [2011] SCJ No 26

² *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3, clause 67(1)(a).

³ *Constitution Act* 1867, s 92(13)

jurisdiction of Parliament.⁴ Under established constitutional principles, federal legislation will prevail in the event of conflict between the exercise of the respective legislative powers of provincial legislatures and the Parliament of Canada. However, this does not give Parliament *carte blanche* to take over the law of trusts.⁵ Nor has it attempted to do so. However, it has exercised its constitutional power to deal with trusts as necessarily incidental to a federal system dealing with bankruptcy or insolvency.⁶ For example, under sections 95 or 96 of the *Bankruptcy and Insolvency Act*⁷ (BIA), a preferential transfer of property or a transfer at under value effected through a trust can be set aside by order of a court.⁸

In the following paragraphs of this paper, the author briefly explores the conceptual factors that the courts have applied when determining the appropriate accommodation between trust and insolvency law. The paper addresses this accommodation in the context of six categories of trusts: express and implied trusts, resulting trusts, remedial trusts, deemed statutory trusts, and trusts mandated by statute benefiting the Crown or others.

TRUSTS IN THE CONTEXT OF BANKRUPTCY

Non-statutory “Real” Trusts

The classic pattern established in equity for the creation of a trust is the transfer of legal or equitable ownership of property (*res*) by a settlor to a trustee on conditions generally designed to benefit a third person. The oft-enunciated requirements for the creation of a trust are: (1) certainty of the intention (expressed or implied) to create the trust, (2) certainty of the subject matter or trust property; and (3) certainty of the objects of the trust.⁹ There is no room for debate when it is established that a bankrupt or insolvent person holds property acquired by the person in a context in which these factors prevail; the trust property is not subject to federal bankruptcy and insolvency law.

There are circumstances in which trusts are found to exist even though a superficial examination of the relevant facts does not immediately point to their existence. This is the case where an implied or

⁴ *Constitution Act, 1867*, s 91(21)

⁵ *Sun Indalex Finance LLC v United Steelworkers* [2013] 1 SCR 271, per Dechamp J. at paras. 50-57.

⁶ *British Columbia v. Henfrey Samson Belair Ltd* [1989] 2 SCR 24.

⁷ *Supra* note 2.

⁸ These provisions may apply to a proposal under the *Companies Creditors’ Arrangement Act* RSC 1985, c C-36, s 36.1.

⁹ *Century Services Inc. Canada (Attorney General)*, 2010 SCC 60 (CanLII), [2010] 3 SCR.379, at para. 83, per Deschamps J.