

# “Letter of Wishes” for Wills and Discretionary Trusts

When a trust is established, a trustee is appointed and the terms under which the trustee is to administer the trust property are specified. Sometimes the terms of the trust are quite straight-forward: the trustee is to keep the capital of the trust invested; distribute the income to the named beneficiaries on a prescribed basis; and distribute what is left of the trust property to identified beneficiaries upon attaining a specified age or upon the occurrence of a specific event. However, other trusts provide the trustee with broad discretion in administering the trust. This article will discuss the role that a “Letter of Wishes” (or “Precatory Memorandum”) can play in providing guidance to the executor of a Will or trustee of a discretionary trust.

## Why use a Discretionary Trust?

A trust is often discretionary because the creator of the trust (either the testator who creates a testamentary trust through a Will, or the settlor who creates an inter vivos trust) knows that he or she cannot foresee how the future will unfold and what the needs or circumstances of the beneficiaries might later be. This discretion may extend to the timing, nature, and amount of distributions, as well as potentially determining who among the beneficiaries will receive funds from the trust. Please note that there are certain exceptions for testamentary spousal trusts<sup>1</sup> and for Alter Ego and Joint Partner Trusts<sup>2</sup>. For more information, ask your BMO financial professional for a copy of our publications, *Planning for Spouses and Children Using Testamentary Trusts* and *Alter Ego and Joint Partner Trusts*.

Discretionary trusts are often used when planning for disabled beneficiaries who receive income or asset-tested social assistance benefits. In these cases, the trustee’s discretion is often absolute; the beneficiaries have no “vested interest” or fixed entitlement to receive funds from the trust. Such absolute discretionary trusts are also known as “Henson trusts.” For more information, ask your BMO financial professional for a copy of our publication, *Special Needs Beneficiaries Require Special Estate Planning*.

In order to provide the trustee with some direction, the creator of a discretionary trust is often advised to provide the trustee with guidance on how to exercise their discretion. This guidance often comes in the form of a separate, non-binding letter to the trustee, typically called a “Letter of Wishes”

(“Letter”) or a “Precatory Memorandum” (“Memorandum”). The purpose of the Letter or Memorandum is to give the creator of the trust some comfort that despite no longer being in control of the trust property, the distributions will be made with respect to his/her own values and priorities. As a Letter of Wishes is not legally binding on the trustee, a beneficiary would find it difficult to successfully challenge the trustee’s decision in court should the trustee choose not to comply with the recommendations in the Letter or Memorandum.

Discretionary trusts are also used to facilitate tax planning, for asset protection, creditor-proofing or for family law purposes. Most Letters of Wishes will request that the trustee consult with a knowledgeable lawyer and accountant prior to making any significant distributions to ensure that they are made with the relevant law and policy considerations in mind. The Letter may also name other individuals such as a family friend to be consulted by the trustee before decisions are made.

## What does a Letter of Wishes say?

In the Letter of Wishes, the creator of the trust may share with the trustee personal preferences and guidelines based on the family’s history. This is particularly important when the initial trustee and their successors may not be familiar with the circumstances of the beneficiaries or the trust property, or they may not be local and aware of relevant government policy or legislation, or they may be an institution such as a trust company.

These guidelines may provide specific amounts, ages, or examples for the trustee to consider, such as:

- A suggested annual gift or monthly allowance for certain individuals until a certain age;
- Describing a scenario in order to personalise broad legal terminology, such as "maintaining a beneficiary's standard of living" or making "sufficient funds" available for a beneficiary's health, maintenance, welfare and support;
- A maximum amount to be used for specific items, such as tuition or an automobile; or
- A maximum amount for business start-up costs or the down payment for a first home provided that the beneficiary can support the remaining operating or financing costs.

These guidelines may also recommend the priority for use of funds when considering the following:

- Should requests to use trust funds to support education be prioritized over the down payment for a first home?
- Should the payments from the trust be sufficient to financially support the beneficiaries? Or rather, should they be sufficient to enhance their lives while obliging the beneficiaries to provide for their own support?
- Should spending be limited so that the trust lasts for the duration of the beneficiary's lifetime or until a certain age?

Certain guidelines or directions may need additional support from the wording of the trust document or Will itself in order to be effective. This is particularly important where the exercise of discretion in favour of one beneficiary may negatively impact or even exclude another current or future beneficiary or class of beneficiaries. This is called "lifting the even hand rule." Examples where such additional wording may be required in the Will or trust document itself includes:

- Is there a willingness to make large distributions before the beneficiary dies or reaches the specified age in the trust, and to what degree? Can the trust be paid out completely before that time?
- Should the trustee be making distributions with a view towards ensuring that there are assets to be distributed to the next generation of beneficiaries on the death of the lifetime beneficiary (i.e., if there is a trust for a child and grandchild, should distributions be made to the child with the goal of ensuring there are still assets to distribute to the grandchild on the child's death)?

- Should the trustee prioritize the needs of one beneficiary over the others? Or, should all beneficiaries receive the same amount?

These guidelines may also touch on family business succession issues or the allocation of the family's real estate portfolio. For example:

- If the trust property includes shares in the family business, is there an order of preference for which beneficiary should receive those shares and when? If the family business is to be sold to a third party, are there preferred potential purchasers, valuers, and accountants to engage?
- If the trust property includes a portfolio of real estate, is there an order of preference for each beneficiary to select individual properties as part of their trust distribution? If there is a family vacation property, are there guidelines in place for when the beneficiaries can use it, and on what terms?

### Other potential uses for a Letter of Wishes

A Letter of Wishes may also be used to inform the executor in respect of preferred beneficiaries to receive certain personal effects (i.e., jewelry, collectibles and art work). However, because it is not legally binding, a Letter of Wishes should not be used for valuable or potentially contentious items. These should be dealt with in the Will itself. A Letter of Wishes can also be used to track any advances on inheritances that should be factored into an estate's total value before any distributions are made. These can include the outstanding amount of loans to children which are not to be forgiven, or for gifts which should be taken into account. How these loans or advances are to be treated on death should be specified in the Will itself.

A Letters of Wishes can also be used to provide guidance on more personal matters related to a Will. For example, it may give guidance to named guardians, indicating preferences on how the minor children should be raised and supported. It may also clarify preferences on end of life ceremonies, including the venue, type of music, and preference for burial or cremation.

### Best practices

Where appropriate, a Letter of Wishes serves as a convenient and inexpensive means for the trust's creator to update the guidelines to the trustee without having to formally change the trust document (i.e., creating a new Will or codicil, or amending the terms of an inter vivos trust) each time an update is called for.

Like most estate planning documents, the Letter of Wishes should be reviewed on a regular basis and amended as situations change. For families with young children, this may be on an annual basis.

Each time you create or update your Letter of Wishes, it is recommended that you sign and date it, keep the original together with your original Will, and give a copy to your lawyer, trustees, and other trusted advisors.

A lawyer is not required to create or update a Letter of Wishes. However, it is always recommended that you obtain legal advice to determine whether the guidance you are looking to provide can be achieved by a non-binding Letter of Wishes alone, or whether the Will or trust document itself needs to be amended in order to give effect to your wishes while preserving the integrity of your other estate planning objectives.



**For more information, speak with your BMO financial professional.**



<sup>1</sup> In order to receive preferential treatment under the Income Tax Act, a testamentary spousal trust must meet certain conditions, including that during his/her remaining lifetime, the surviving spouse must be entitled to receive all of the income from the trust and be the only one entitled to receive any distributions of capital from the trust. Distributions of capital to the spouse may be at the discretion of the trustee(s).

<sup>2</sup> In order for an Alter Ego or Joint Partner Trust to receive preferential treatment under the Income Tax Act, certain criteria must be met which necessarily limit the extent of discretion exercisable by the trustee. The settlor of an Alter Ego Trust must be entitled to receive all of the income of the trust until his/her death and no person other than the settlor may be entitled to receive or have the use of the capital of the trust during his/her lifetime. In the case of a Joint Partner Trust, the two partners must be entitled to receive all of the income of the trust until the death of the survivor of them and no person other than the two partners may be entitled to receive or have the use of the capital of the trust until the death of the survivor.

BMO Wealth Management provides this publication for informational purposes only and it is not and should not be construed as professional advice to any individual. The information contained in this publication is based on material believed to be reliable at the time of publication, but BMO Wealth Management cannot guarantee the information is accurate or complete. Individuals should contact their BMO representative for professional advice regarding their personal circumstances and/or financial position. The comments included in this publication are not intended to be a definitive analysis of tax applicability or trust and estates law. The comments are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances.

BMO Wealth Management is a brand name that refers to Bank of Montreal and certain of its affiliates in providing wealth management products and services. Not all products and services are offered by all legal entities within BMO Wealth Management.

BMO Private Banking is part of BMO Wealth Management. Banking services are offered through Bank of Montreal. Investment management services are offered through BMO Private Investment Counsel Inc., an indirect subsidiary of Bank of Montreal. Estate, trust, planning and custodial services are offered through BMO Trust Company, a wholly owned subsidiary of Bank of Montreal.

BMO Nesbitt Burns Inc. provides comprehensive investment services and is a wholly owned subsidiary of Bank of Montreal. If you are already a client of BMO Nesbitt Burns Inc., please contact your Investment Advisor for more information. All insurance products and advice are offered through BMO Estate Insurance Advisory Services Inc. by licensed life insurance agents, and, in Quebec, by financial security advisors.

® is a registered trade-mark of Bank of Montreal, used under licence. All rights are reserved. No part of this publication may be reproduced in any form, or referred to in any other publication, without the express written permission of BMO Wealth Management.