

STEP

Society of Trust and Estate Practitioners

7TH CANADIAN NATIONAL CONFERENCE

METRO TORONTO CONVENTION CENTRE

JUNE 6 AND 7, 2005

VALUING INTERESTS IN TRUSTS

by

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VALUATION OF CAPITAL INTEREST IN NON-DISCRETIONARY TRUST

■ Factors considered:

- Expected date capital will be distributed to beneficiary
- Anticipated annual rates of return
- Anticipated growth rates in asset values
- Capital intended to be reinvested
- Capital intended to be distributed to beneficiaries
- Anticipated distributions to other beneficiaries

VALUATION OF INTERESTS IN DISCRETIONARY TRUSTS

■ Factors considered:

- Obligation of trustee(s) to maintain even hand *vis-à-vis* all beneficiaries
- Fair market value of trust's assets
- Legitimate expectations and legal rights of other beneficiaries
- Likelihood of trustee(s) exercising power in favour of subject beneficiaries

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VALUATION OF INTERESTS IN DISCRETIONARY TRUSTS

■ Additional factors (over and above standard factors applicable to non-discretionary trusts — see above):

- Number of beneficiaries
- Beneficiaries' ages
- Obligations of trustee(s) under trust provisions
- Settlor's overall estate plan
- Trustee's possible plans for trust's assets

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VALUATION OF INCOME INTERESTS IN NON-DISCRETIONARY TRUSTS

■ Factors considered:

- Life expectancy of beneficiary
- Nature of trust's capital
- Estimate of rate at which income will be generated by trust capital
- Probability of beneficiary encroaching on trust capital
- Income taxes payable by beneficiary on trust income
- Rate of return (discount rate) to present-value future after-tax cash flow generated by trust capital

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SPIRING v. SPIRING

2004 M.B.Q.B. 55

- Use an "if and when" approach, as in *George v. George*
 - [1983] 5 W.W.R. 606 (Man. C.A.)

OR

- Notional pro-rata distribution of trust value among capital beneficiaries as of valuation date
 - *Sagl v. Sagl* (1997), 31 R.F.L. (4th) 405 (Ont. Gen. Div.)

[NOTE: "Fair value" concept]

OR

- Consider if contingent beneficiaries will, in fact, receive distribution and quantify amount
 - *Kachur v. Kachur*, 2000 A.B.Q.B. 709

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DISCOUNTS TO BE APPLIED TO INTEREST IN TRUST

- Lack of marketability
- Illiquidity
- Beneficiary's inability to control trust
- Contingent taxes

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FACTORS CONSIDERED IN QUANTIFYING MARKETABILITY DISCOUNT

- Restrictions on transferability
- Holding period of the shares
- Required holding period return
- Dividends during holding period
- Capital appreciation during holding period

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FACTORS CONSIDERED IN QUANTIFYING MARKETABILITY DISCOUNT (CONTINUED)

- Nature of company
- Management
- Degree of control comprised in the shareholding
- Company's redemption policy
- Company's position in industry

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SUPPORT FOR DISCOUNTS FOR LACK OF MARKETABILITY

RESTRICTED SHARE APPROACH

Private placements of restricted shares of public companies

vs

Their publicly-traded counterpart (shares having attributes identical to those of restricted shares, except that they are freely-traded)

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**SUPPORT FOR
DISCOUNTS FOR LACK OF MARKETABILITY
APPROACHES CONSIDERED BY U.S. TAX COURT:**

PRE-IPO APPROACH

Market prices of shares of a public company following an initial public offering ("IPO")

vs

Private transaction prices of same company's shares prior to IPO

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**SUPPORT FOR
DISCOUNTS FOR LACK OF MARKETABILITY**

QUANTITATIVE APPROACH

Uses quantitative models, including criteria generally considered by market participants:

- Dividend yield
- Required holding period
- Capital appreciation
- Prospects for liquidity

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BLACK v. BLACK
LACK OF MARKETABILITY AND LACK OF CONTROL

" ... I found the following facts to be the most determinative of the value of the husband's business interest [a 50% interest in a holding company in which the shareholder's brother, Conrad Black, owned the other 50%]: the *highly-illiquid* nature of those interests and the substantial third party debt to which they were subject; that a purchaser of them would not be buying control or a route to control of their underlying public companies" (Emphasis added.)

The Hon. Mr. Justice Walsh
Black v. Black
(1988) 18 RFL (3d) 303 (Ontario HC), at 313

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**VOTING RIGHTS IN
TWO-CLASS SHARE STRUCTURES**

**Possibly three separate and distinct
common shareholdings to be valued:**

1. Common shares that have the majority of the voting rights/votes
2. Common shares that are voting, but have minority voting rights
3. Common shares that are non-voting

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CRA POLICY

- "We deliberately keep the number of policies down to an absolute minimum."
- "Mandatory valuation policies and positions can adversely affect the perceived independence of CRA's valuers and can prejudice their position as independent experts in court. CRA therefore very reluctant to bind valuation staff to formal policies without compelling reason."

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CRA POLICY

- "There is no compelling reason to establish CRA valuation policies apart from the few current "greater certainty" areas specifically related to tax driven transactions."
- "This is why we have not established national policy positions on contentious areas of general valuation concern such as latent taxes, arm's length minority discounts and blockage/liquidity discounts, or premiums."

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CRA POLICY

- “Generally, private sector valuers do not take fixed, inflexible position on latent taxes. Each case reviewed on own merits and valuator’s conclusions are based on specific facts of the company under review.”
- “A formal valuation policy on this issue would lock CRA valuers into a fixed methodology regardless of the facts in individual cases. This position would not be tenable.”

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CRA POLICY

- “We will not establish a mandatory departmental approach on this valuation issue until such time, if ever, as there is a general consensus in the valuation community on how it should be handled. Private sector valuers review each case on its own merits and we reserve the same right.

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TAX COURT OF CANADA

"The United States authorities ... , while not binding, are entitled to respect and are illustrative of the way in which U.S. courts, operating under a different statutory regime, have sought to cope with the valuation of unique and in some cases unmarketable properties. One must, however, treat foreign authorities with caution."

Hon. D.G.H. Bowman, (then) Associate Chief Justice
Aikman v. The Queen
[2000] 2 CTC 2211; aff'd [2002] DTC 6874

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TAX COURT OF CANADA

"Considerable argument was devoted to a number of United States Tax Court decisions. That court has had to deal with very similar arrangements. ... one must treat foreign authorities with caution, but they are entitled to respect and they can be instructive where they deal with essentially the same problem."

Hon. D.G.H. Bowman, (then) Associate Chief Justice
Klotz v. The Queen, 2004 TCC 147

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