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Death Taxes

by

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This is one of a series of studies that have been prepared for the Royal Commission on Taxation. Although these studies are published under the auspices of the Commission, this does not necessarily imply that the Commission agrees with the views expressed.

FOREWORD

This study was written during 1964. Some references were added in September 1966, citing a few recent cases and reflecting some changes in departmental practice.

The views expressed herein are those of the authors and are not necessarily those of the Commissioners.

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CHAPTER 1—INTRODUCTION

In Canada, the field of death duties was occupied entirely by the provinces until 1941, when, soon after the Rowell-Sirois Commission had recommended exclusive occupation of the death duty field by the Dominion, the federal government enacted the Dominion Succession Duty Act 1/ because of the pressing need for revenue. In 1958, the Estate Tax Act 2/ was passed to come into force on January 1, 1959. This Act replaced the Succession Duty Act for estates of decedents dying after December 31, 1958.

Under the British North America Act, the federal government may levy either direct or indirect taxes, but the provincial governments are restricted to direct taxes for provincial purposes. While succession duties are a direct tax so that both levels of government are competent to levy them, it is usually asserted that estate tax, being an indirect tax, is beyond the jurisdiction of the provinces. Although an argument can be made for a provincial estate tax provided the executor is made the collecting agent for the provincial Crown, no province has so far attempted this.

Despite federal entry into the death tax field, Ontario, 3/ Quebec, 4/ and British Columbia, 5/ levy succession duties. Under the Federal-Provincial Fiscal Arrangements Act, 6/ each province not levying a succession duty was entitled to 50% of the federal estate tax collected in that province, the others receiving a 50% abatement through tax credits. In November 1963, at the Federal-Provincial Conference, it was decided to increase this to 75%. Legislation effecting this change was enacted by means of the Federal-Provincial Fiscal Revision Act, 1964, 7/ which provided that an additional 25% of revenue from estate taxes collected during the period April 1, 1964 to March 31, 1967, would be paid to provinces that do not levy succession duties and to provinces which do levy succession duties but which do not increase their succession duty rates beyond the rates in effect on March 31, 1964. Neither Ontario nor Quebec increased their rates and so qualified for the additional 25% under this provision, along with those provinces which do not levy succession duties. The Estate Tax Act was amended 8/ to provide for an additional tax credit of 25% (making a total of 75%) applicable where the deceased died after March 1964, if the deceased was at the time of his death domiciled in a "designated" province. Only British Columbia is a "designated" province, since it raised its succession duty rates to give effect to the change.

In searching for an acceptable theoretical basis of death taxation, and in asking whether it can be justified in the present Canadian tax structure, it would appear doubtful whether it has any rationale other than the raising of revenue and as a final check on income tax. Notwithstanding that there have been no less than 12 theories advanced in support of some kind of death taxation, research would indicate that the original and subsisting primary reason for the existence of the Estate Tax Act is as a revenue raiser. If the tax is designed primarily to promote redistribution and to prevent accumulations and perpetuations of large fortunes, there is little evidence of its success. Family fortunes are still perpetuated in Canada. Yet as a revenue raiser, the estate tax has been equally ineffective. Until 1963 no more than 90 million dollars was raised annually from this tax out of a gross federal tax revenue of over 4 billion dollars.

The estate tax did not go unnoticed in submissions and oral representations to the Royal Commission. Some questioned the necessity of a death tax in our tax structure. Most frequently discussed, however, were the method of taxing annuities, the level of exemptions, the problem of valuation, and the adoption of the concept of husband and wife as one entity, reference being made here to the United States marital exemption for estate tax purposes, together with the advantage conferred generally on persons in community of property under Quebec laws. These criticisms and suggestions were helpful and worth while and they assisted in the technical detailed analysis of the existing estate tax law. Research on broad policy lines led to consideration of possible alternatives, including succession duties, transfer taxes, accession taxes, wealth taxes and similar fiscal measures.

This study is concerned with two alternative assumptions, namely:

(1) that the present estate tax be retained,

(2) that the present estate tax be replaced by some other tax.

The following chapter is an extensive analysis of the problems found in the existing law together with recommendations or suggestions for their correction. These may be divided into broad questions of policy which are dealt with in the body of the study and narrower but nonetheless important issues of drafting and language interpretation which are discussed in Technical Appendix I and summarized in Technical Appendix II.

The last chapter of the Study discusses new taxes to replace both estate, and gift tax, and some comments and suggestions respecting their actual form are presented. The division of areas of review between the body of the study and the Technical Appendices has a further significance, in that those 18 areas summarized in Chapter 2 are broad ones which could be applicable to alternative types of death taxes. On the other hand, the 29 suggestions in Technical Appendix II are more directly concerned with the present Act.

REFERENCES

1/ S.C. 1940-41, c. 14.

2/ S.C. 1958, c. 29. In this study, unless otherwise specifically stated, all section references are to its provisions.

3/ The Succession Duty Act, R.S.O. 1960, c. 386.

4/ Quebec Succession Duties Act, S.Q. 1943, c. 18.

5/ Succession Duty Act, R.S.B.C. 1960, c. 372.

6/ S.C. 1960-61, c. 58.

7/ S.C. 1964, c. 26, s. 4(2).

8/ S.C. 1964, c. 8, s. 3(1).

CHAPTER 2—EXISTING LAW

GENERAL REVIEW

In five operative years, the Estate Tax Act has been generally fair in its levy and, except in one or two areas specifically dealt with below, has not caused any untoward or excessive hardships. It has been adequately and often generouly administered, the administrators treating taxpayers equally and justly within the limits of common sense and legal rules. However, certain loopholes and anomalies exist, and the following observations are made in connection therewith.

It is understood that the drafters of the Estate Tax Act attempted to make it readable to the "man on the street". To this end, considerable attention was given to simplicity of language and expression. However, the Act is not simple or easy to read, nor is its language always clear or free from ambiguity; the Court decisions on issues arising under the Act bear witness to this. These comments are not criticisms of the framers of the Act. Indeed, one must be resigned to the fact that taxing statutes must often of necessity go beyond the understanding of the man on the street. Simplicity and equity seldom go hand in hand, and intricacies, subtleties, and complexities are sometimes needed to ensure, as nearly as possible, that each person pays his share of tax. The Estate Tax Act does in the main reach this result. It is commendably clear in its overall structure.

LIFE INTERESTS

Consideration has been given to the taxation of life interests which cease with the life of the life tenant. In England, it has been held under section 2(1)(c) of the English Act that when a life interest or a series of life interests cease, there is a passing of property. These decisions rest on the concept that property passes whenever there is a change in beneficial possession or present enjoyment. 1/ Thus when the life tenant dies, the remainderman's interest falls into possession and this is sufficient to constitute a "passing". The first English decision on this point laid much stress on the word "settled" in the English Act, which refers to all property passing, whether settled or unsettled. 2/ No such reference is made in the Canadian Act, and on this ground alone a distinction might be made. Also this early English case has been criticized by a later House of Lords decision. 3/ In view of the construction placed on the Canadian Act by our Courts, and considering the difference in language between the English and the Canadian legislation, the authors take the view that life estates cannot be taxed here. Administrative practice conforms with this view, the officials charged with the Act's administration having made it clear that they have not taxed in the past, nor do they intend to tax in the future, life estates. 4/

But, the basic issue remains: should such interests be taxed? England taxes not only life estates as property which passes, but also certain other interests, such as continuing annuities, which cease upon the death of the annuitant. 5/ Exemption of life estates from tax creates an avenue for avoidance in that property may be passed down from generation to generation by means of a succession of life interests.

The only effective limits to this are the testator's own wishes and the rule against perpetuities. How much revenue is lost in this manner has not been estimated, as available statistical data are insufficient. However, revenue considerations for our purposes are relatively minor as this Study is more concerned with questions of equity and consistency. A probable result of this policy is that it encourages testators to create trusts and settlements, which contribute to national savings and investment capital, rather than to leave estates outright to inheritors who might quickly squander and dissipate the estate. Also, there is an equitable argument against burdening the balance of a decedent's estate because of the cesser of his life interest. This might cause hardship to dependent relatives and create problems in the organization and distribution of the estate. However this effect could be somewhat mitigated, as it is in England, where, if the balance of the estate is small, the settled property is not aggregated with it for duty purposes, and where there is no duty imposed on the death of the life tenant if the life tenant was the surviving spouse of the deceased. Note also that the United States tax laws do not tax life estates.

On the other hand, the authors believe that this is a major defect of the death tax in that a minor change in the form of, and the channel through which, property is transmitted, effectuates a substantial difference in the tax burden, even if the ultimate beneficiary is the same, and even though the variation in tax is not properly related to any social objective. This inequitable and capricious difference puts pressure on a prospective decedent to transfer to ultimate beneficiaries with as few intervening transfers as possible. This has various consequences:

(1) The normal procedure of transfers to those in the family to whom one owes the greatest obligation, e.g., the surviving spouse and immediate children, is interfered with. (2) Ultimate beneficiaries are selected for tax reasons rather than for reasons of responsibility, ability, requirements, and affection. If tax consequences, rather than normal considerations, motivate a mode of transfer, the tax is not neutral. (3) The differential in tax treatment is quite disproportionate to the normal difference in actual benefits enjoyed. (4) Complicated testamentary instruments, trust provisions, powers of appointment, etc., are required, with consequent high legal fees, litigation, high overheads on institutional investments, and decreases in the supply of risk capital. (5) Revenue is depleted.

Such tax discrimination between virtually indistinguishable situations is difficult to justify, particularly when the differential is substantial because of progressive rates. As a general principle, it is believed that, to be satisfactory, the death tax must produce reasonable equality of tax burdens in those cases where, whatever the channels and methods of devolution, the initial and final holders are the same. The burden should not in general be affected by irrelevant or trifling differences in the method of achievement of the ultimate distribution. Any differences that do arise should be related to acceptable social goals. In accordance with these principles, it is suggested that property should be deemed to pass on the ceasing of a life interest, but that, to effectuate a recognized social goal, where the life interest is vested in a surviving spouse, there be an exemption on the ceasing of that life interest.

The authors have considered the aptness of the phrase "property passing" and although a phrase such as "property of person at the date of his death" is more suited to an Act wich does not intend to tax on the basis of a change in beneficial possession or present enjoyment, no change is suggested, as the present phrase is now backed so well by judicial interpretation.

> Summary 1. That the present policy of not taxing the property which passes on the cessation of a life estate be changed, and that the Estate Tax Act be amended to provide that the phrase "property passing on death" include the cessation of a life or other similar interest, with an exempting proviso where the life or other similar interest is vested in the surviving spouse.

DOMICILE OR RESIDENCE

The Estate Tax Act has two parts. Persons dying domiciled in Canada are taxed under Part I and persons dying domiciled outside of Canada but leaving property situated in Canada are taxed under Part II. Domicile is therefore the basic jurisdictional test, though the Act provides no definition of domicile. A study of the common law meaning of domicile was undertaken to ascertain whether it is a sufficiently precise term for present day purposes. At common law, a person is, in general, domiciled in the place or country which is his permanent home, but he is in some cases domiciled in the place or country which, whether it is his permanent home or not, is determined by a rule of law to be his home. The authors find this definition sufficient for the purposes of the Act, and if the domicile test were to be retained, they would not recommend any statutory definition. This is a concept better left to the judiciary for interpretation on a review of the facts of each case.

Consideration has been given to the adequacy of the test of domicile as a basis for estate tax. Other tests, such as nationality, citizenship, residence or domicile of the beneficiary, and situs of property, were considered as possible alternatives. They have all for various reasons been rejected, and the authors have concentrated on the choice to be made between residence and domicile of the decedent. Residence is the jurisdictional basis for income tax and gift tax and as such has a well-understood meaning, even if it is no better explainable than that of domicile. One drawback to the use of domicile is that the differentiation between estates which are assessed on their world estate and those which are assessed on their Canadian-situated property means that non-Canadian-domiciled residents in Canada, whose "economic allegiance" is to Canada by reason of long residence here and a virtually exclusive Canadian-situated estate, will, because they have not been able to satisfy the strict requirements for a change of domicile, find their estate taxed at 15% with only a $5,000 exemption, regardless of the number of related dependants. The other side of the coin is the non-resident Canadian-domiciled person who, despite a foreign "economic allegiance" has been unable to shake off Canadian domicile; some attempt has to be made to value and tax his world estate, which may be virtually exclusively elsewhere than in Canada. When the courts developed the concept of domicile in the 19th century, they made it notoriously difficult to change domicile of origin, thus giving this concept a limited practicality which renders it ill-suited to the social habits of a travelling world in the 20th century. If lengthy residence in a country, even though surrounded with the indicia of permanency, does not necessarily effect a change of domicile, then it is felt that a new test must be found. For a tax which is dependent on a legal concept developed to deal with problems of validity of wills and devolution, and which is potentially far removed from the factual situation, is not only inequitable, but administratively cumbersome. Domicile, therefore, should be rejected, both as an exclusive test and as one in conjunction with others, in that its effect is capricious in either case. The authors considered situs of property as a test, but, both because of the avenues of avoidance opened up, and because in principle the tax should be based on a characteristic of the decedent rather than of his property, they would reject it. They also considered citizenship, but, for a reason to be mentioned below, we found this unsuitable.

The test of residence of the deceased was investigated more closely, and although faced with many counter arguments, the authors are impressed by it. The first argument against the residence test is that estate tax should, unlike annual income tax, be exacted pursuant to a concept closely allied to the country in which the decedent's ties are most permanent. This, however, is as much an argument against domicile as it is against residence; not only can the 19th century rigidity of the domicile test mean that long residence and "economic allegiance" do not necessarily attract domicile, and the opposite—that is, long absence without the loss of domicile—but also its curiously legalistic approach means that on uncontrollable events such as the death of a husband, domicile of origin can be revived when there were never more than the most tenuous of ties with that country. Secondly, it is said that one can have two residences but only one domicile, thereby creating double taxation problems. However, this is what international tax conventions are for, and what another country decides should not in itself dissuade us from adopting what is otherwise a theoretically satisfactory basis for tax. Also, the argument does not favour domicile against residence, for more than one country could claim that a taxpayer is domiciled there, particularly when abstractions such as intention, rather than factual situations such as physical presence, are so important in the determination of the test of domicile. Tax conventions would again have to resolve this problem. Thirdly, it is argued that domicile determines matters of devolution and validity of wills. However, the authors are concerned here with determining who shall be taxed and under which part of the Act; they see no conflict in using one test to tax the estate and another to distribute it. They appreciate that determination of the situs of some property depends on domicile. Thus, for the Canadian resident who would be taxed on his world estate, tax credits for provincial succession duties could be granted whether the province taxed on the basis of residence or domicile, as long as the credits are awarded on the basis of the succession duties paid instead of payable. (See Summary 12.) Further, they do not see that it will be any more difficult to deal with non-residents since the property to be included in the taxable estate is not determined by the same rule that determines the taxability of the deceased. Even now some situs decisions are made on the basis of residence (e.g., debts under section 38(c)), so that in deciding under which part to tax a non-domiciled Canadian decedent reference is made to his domicile but, in deciding whether to include the debts owing to him as part of his Canadian-situated property reference is made to the debtor's residence. The adoption of a residence test would mean that property situated on the basis of domicile would be included in a non-resident decedent's Canadian estate if he were held to be domiciled here.

Other arguments in favour of residence are that the test is consistent with the income and gift taxes, and that it is a practical and essentially "physical" rather than an "abstract" one; as was said at the 1963 Canadian Tax Foundation Conference:

> It is comparatively easy to ascertain the physical fact of residence. It is increasingly difficult in this transient world to ascertain domicile which can only be done by considering not only facts relating to residence but also an abstraction, namely, intention. 6/

Domicile can operate so as to have nothing to do with economic allegiance, and on analogous grounds citizenship should also be rejected. Residence indicates a real connection with a country. As was said in a Report on Double Taxation submitted to the League of Nations Financial Committee:

> Permanent residents owe some duty to the place where they live, even if their property is situated or their income derived elsewhere. 7/

But residence as a test will always need some economic connection with the country of residence. "Residence" on its own could have a connotation which embraces temporary residence of those passing through or visiting a country. It would not appear desirable to tax under Part I the estates of those dying in Canada under such circumstances. The authors prefer "ordinary residence", which is interpreted in the context of the Income Tax Act to require something more permanent than casual "residence". And to give the test that factor of permanency which would differentiate it from the annual income tax, it is suggested that the deceased must have been ordinarily resident in Canada throughout the 12 months immediately preceding death. It appears that the test of domicile, hallowed as it is by its use in those countries from whence we gain our judicial and economic concepts, is chosen for no better reason than that it is relatively difficult for a Canadian to lose his domicile even if he severs all ties with Canada. This reasoning is contrary to the "economic allegiance" doctrine which the Report to the League of Nations Financial Committee, mentioned above, said should apply no less to death duties than to the income tax or the property tax. The authors are therefore prepared to suggest that the domicile test be replaced by a test of ordinary residence.

Summary 2. That the domicile test be replaced by a test of ordinary residence throughout the 12 months immediately preceding death.

LOSS OF RESIDENCE

It is appreciated that the above suggestion aggravates a problem which already exists with the domicile test. The authors have heard of those, whose wealth is such that death taxes have an overriding influence, who have deliberately set out to lose their Canadian domicile. It is these wealthy people who matter with such a tax, and a residence test will make its avoidance all the easier. (Citizenship would be the simplest test to evade for many persons, as, e.g., a British subject— that is, generally, a member of the British Commonwealth can utilize most of the benefits of the Canadian way of life without retaining Canadian citizenship.) 8/ So the argument that residence is easy to lose is not one of weight, as the same point can be made of all tests where a characteristic of the decedent is the touchstone, though with residence it is recognized that the avenue for escape is broader. Thus, the next suggestion is one which can be applied whether domicile or residence is the test. Loss of Canadian domicile or residence involves the wholesale severing of economic ties with Canada. Residences are sold, businesses may be wound up, and investments may be transferred or changed. It is at this moment that Canada could justifiably impose a tax on the capital assets of those who have enjoyed the benefit of Canadian government with the corresponding obligation to pay taxes for that benefit. As far as the Treasury is concerned, this moment is as effective a severance by the resident with the country which has afforded him protection and livelihood, as is his death.

It is not suggested that the departure of the taxpayer leaving Canada can be deemed to be his death, or that a net wealth tax can be imposed at that point for, on death in the country of adopted residence, a second tax would be imposed, not only by that country, but under Part II of our Act. Credits could be used to deal with both, but in the first case only by treaty (which we anticipate may be difficult to negotiate), and in the second case only coupled with extensive avoidance-blocking legislation to deal with gradual withdrawals of Canadian-situated property. Such a tax would produce considerable uncheckable evasion and also would inhibit the adoption of Canadian residence. It is pointed out in the study on capital gains that loss of residence is an attractive escape hatch, and it is therein suggested as a solution that there be a deemed disposition of all property by a resident on the last day of his Canadian residence, so that the capital gains tax may be imposed on accretions to net wealth. Some requirement that all emigrants need a tax clearance would be necessary. It is not suggested that any tax on net wealth could or should be imposed in addition to this, and the authors are content to adopt here the suggestion contained in the study on capital gains.

<u>Summary 3</u>. That the only tax to be imposed on loss of permanent residence should be that recommended in the capital gains study as a tax on gains constructively realized.

TAX ON NON-RESIDENTS

Under Part II of the Estate Tax Act, a person dying domiciled outside Canada but with assets situated in Canada may be taxed, the traditional justification being that of a "quid pro quo". Where someone not domiciled in Canada takes advantage of Canadian stability, invests in Canadian resources, and owns property here, he ought to pay something in return for the protection he receives from the country's laws. The authors have already endorsed this theory above and support its continuation as a legitimate tax policy. Foreign estates above the value of $5,000 are subject to a flat-rate 15% tax. 9/ The Estate Tax Convention with the United States 10/ has raised this exemption to $15,000. 11/ The present flat-rate tax may cause hardships. Those who come to Canada to work and live for a considerable period and who accumulate assets but fail to acquire a Canadian domicile suffer from the low exemption at the flat rate. For instance, where a Canadian-domiciled decedent leaves a widow and four qualifying children and an estate of $100,000, the tax is $0 whereas a similar non-domiciled decedent's estate pays a tax of $14,250. The suggestion as to the adoption of a residence test would resolve this difficulty in the large majority of cases. However, a problem would still exist with non-residents of Canada who have Canadian property and are taxable under Part II. The adoption of the residence test will in one way widen the net of Part II, in that Canadian residence would now be more readily lost without a necessarily concomitant severance of economic ties. One solution would be to allow the executor the option of choosing under which Part of the Act to be taxed. The benefits of the Part I exemptions could be taken if this were advantageous. Tests for such an option, would probably be too difficult and would add unnecessary complications to the Act. The authors think that a graduation of the Part II tax in accordance with the size of the estate is the most equitable solution, and see no compelling justification in reason, practice or theory, for an abandonment of graduated rates here. Any administrative convenience the flat rate has is not, in their view, overriding, and they are not convinced that graduated rates in Part II would cause excessive administrative problems, as the estate has to be valued in any event.

Summary 4. That a graduated tax be imposed upon Part II estates.

SMALL BUSINESSES

A standard criticism of the Estate Tax Act is that estate taxes are causing hardship to small businesses, and forcing sell-outs to either large corporations or foreign interests or both. This is a serious criticism and if correct it must receive careful attention, leading to a fundamental examination of the tax. Elimination of small businesses through wholesale mergers into larger corporations or takeovers by foreign commerce is not, in the authors' opinion, in the national interest. They therefore set out to gather evidence to assess the magnitude of the problem. Individuals and corporations responsible for administration of estates were canvassed by the Royal Commission and asked to submit factual evidence of cases where estate tax was the dominant factor in the sale of a small business. While a few specific instances were revealed, in many cases the fundamental reason lay somewhere else than with estate taxes. Such reasons as an offering price too attractive to resist, a lack of management capacity in the remaining family, such as a spendthrift son, a disinterest in the business, or the certain knowledge that the business was on a steady decline, were among the most prevalent. In some cases, a sale does appear to have been made prior to the death of the principal shareholder in anticipation of estate taxes. However, it is the authors' view that the Act does not restrict estate planning which could obviate many problems which arise on death. It is open to all to take advantage of this, and it is concluded that even those sales which take place prior to death are often motivated by factors extraneous to estate tax. This subject was investigated in England by a body set up to study national debt and taxation. That group found that, while cases of hardship do occur, "...the Estate Duty does not appear to be a major factor tending toward the disintegration of private businesses."12/ Although this conclusion was reached some years ago and in another country, it states accurately our own opinion. In addition, this matter has been discussed with officials of the Treasury Department, Washington, D.C., who state that this complaint is perennial in the United States, but they have absolutely no empirical evidence to indicate that estate tax is a major factor in the sale of small businesses. The whole subject of hardship to small businesses resulting from estate tax is interwoven with the area of accumulated surplus which has been the cause of so much income tax legislation. The Ives Commission of 1945 recommended certain changes to the Income Tax Act which were in some measure adopted. It appears that the existing provisions of the Income Tax Act and the Estate Tax Act make it possible to prepare for the measure of liquidity needed on the death of the principal shareholder of a small corporation whose estate consists primarily of shares in that company. It is also noted that the Estate Tax Act provides for instalment payments of tax in cases of hardship. It is realized that section 16 rests on ministerial discretion but no situation was cited to the authors where an improper refusal occurred, and therefore have reason to believe that the application of this provision has often not been requested by executors when they might well be entitled to it. No suggestion is therefore made in this matter.

THE ANNUITY PROBLEM

The authors now refer to what may be compendiously described as the "annuity problem"—where the decedent leaves to the successor the right to income for a period of time which may end before the death of the successor but will certainly end at his or her death. The main issues which arise are those of valuation and payment. These problems received the attention of more submissions to the Royal Commission on Taxation than any other point in the estate tax. An example will pose the problem. A husband dies, leaving his wife, who is thirty, and incurably sick, an annuity of $100 a month until her death. The annuity is valued according to mortality tables set out in the Act at a compound interest factor of 4%, the value being $23,500. However, the wife is only given eight years to live by doctors, so that she will probably only receive a small portion of the annuity. Also, estate tax must be paid immediately on the capitalized value of that annuity, the inclusion of which drives up the rate on the total assets of the estate. If the wife dies seven years later, the estate of the husband (assuming a taxable estate) paid estate tax on a value far in excess of the actual amount received, $8,400. Representations on this point were made to the Minister of Finance prior to the enactment of the present Act. Some urged that such income rights be tax-exempt, but to this the Minister did not—rightly in the authors' opinion—accede. They see no justification for discrimination in favour of this type of asset save in respect of the method of payment. Agitation for change of treatment continued after the Act came into force, and in 1960 section 15A was enacted which allows a refund of estate tax where an annuity or other income right was included in an estate, but ended within four years of the death of the testator. Section 15(1)(b), which was in the Act from its inception, in some cases allows instalment payments of the tax on an annuity over a six-year period. Although these two provisions have alleviated hardship to some extent, they do not provide the real answer to the problem. The authors have concluded that a completely new approach is necessary, examined many suggestions made in submissions and have developed their own ideas from the material supplied. The following is a method of taxing annuities and other income rights which they believe would satisfy both the taxpayer and the tax collector.

There are two parts to the problem:

(i) valuation, and

(ii) payment of tax.

Valuation

Valuation should be on the basis of up-to-date and applicable mortality tables.

(a) Mortality tables can be challenged as not reflecting fair market value in the particular circumstances, but only if the tax thereon is to be paid in a lump sum.

(b) If tax thereon is to be paid in instalments, the mortality tables are binding on the estate.

(c) If an appeal is taken against the mortality tables, the burden of proof lies with the taxpayer.

Payment of Tax

The estate should have an option as to method of payment.

(a) Tax thereon can be paid in a lump sum, (in which case mortality tables can be challenged).

(b) Tax thereon can be paid in instalments, the tax being deducted at source from each annuity payment. If such a method is chosen, the tax is paid for the life of the annuitant whether it is shorter or longer than the life expectancy contained in the mortality tables upon which the value is based. The annuitant should have no right to elect to pay the balance in a lump sum after starting to pay in instalments. (The tax to be paid would be the pro rata portion of the estate tax applicable to the cost or present value of the annuity.)

Solution

The authors are aware that to some extent this proposal conflicts with the philosophy that estate tax is a tax on the estate and not on the successors. However, estate tax is usually regarded as an indirect tax, and in reality, it is the successor who bears the burden of the tax. In any event, this problem requires special treatment, and any divergence from strict theory is supportable on empirical grounds. Implementation of this proposal would involve the repeal of section 15A and possibly section 15.

Summary 5. That a change in the method of valuing and collecting estate tax on annuities and other income rights be enacted in accordance with the above procedure.

The authors wish to add a caveat to this proposal.

1. It may be necessary to provide that the mortality tables be subject to challenge if provision is made for instalment payments. It may be that if the tables can be challenged, they should be challengeable even if the tax is to be paid by instalments.

2. The suggested payment system is suspect from a constitutional viewpoint, as it appears that, where the will directs some form of payment of tax different from that prescribed, the Act may well be (as section 14 may well be now) an interference with property and civil rights. For example, a choice between lump sum and instalment payment alternatives could determine which beneficiary effectively bears the tax.

MARKET VALUE

As a general rule, property is included in an estate at its fair market value immediately before the death of the decedent. This rule is varied by special provisions such as those relating to annuities and their income rights, to shares in closely held corporations, and to property which has been the subject of a gift *inter vivos*. The authors endorse the fair market value approach, and conclude that it is the most appropriate for estate tax purposes. Most submissions were satisfied with this rule. One criticism in this area was that no deduction is allowed for the cost of selling property. These costs may include brokerage, real estate commission, appraisers' fees and legal and registration fees, and may be fairly substantial. The net amount received by an estate for property from the proceeds of sale may be much less than the assessed fair market value, because of the costs incurred, so that to tax the gross value is inequitable. The resolution of this problem is not simple, for if costs of sale are to be allowed as a deduction, what of those instances where a testator requires the executor to retain property for, say, two years and then convert it into cash and make a distribution? Are the costs to be estimated, or are no costs to be allowed unless actually incurred, despite the express directions of the testator? The question must be reviewed from two standpoints: (i) those situations where the sale is made at the direction of the testator and, therefore, in effect is similar to a sale by him and (ii) those cases where the sale is really one by the successors. In the latter case it is difficult to agree, given the basic philosophy of an estate tax, that a deduction from fair market value for costs of sale should be allowed. These represent a cost to the successor who is dealing as he wishes with his property. If, however, the sale is "as if" made by the testator, all that would have been in the testator's estate if he has sold before his death would be the net proceeds of sale. On this basis, the deduction should be permitted. However, if a decedent dies leaving no instructions as to sale and the administrator makes a sale, on whose behalf did he make the sale? This may be the most suitable case for allowing a deduction as the administrator will be realizing assets soon after death but, equally, the administrator was probably guided in this by the wishes of the successors. The authors therefore find that in this matter, they can go no further than the following:

> Summary 6. That costs of sale of property in the estate be deductible in those cases where the sale is effected within six months of the date of death, and upon the express testamentary instructions of the deceased.

ALTERNATIVE VALUATION DATE

A frequently raised and hotly debated issue relating to valuation is that of the alternative valuation date. Between death and realization assets may decrease or increase in value. An alternative valuation date would give the estate, within a given time, the option of taking advantage of a decrease in value. The optional feature would have the effect of decreasing taxes where values decline, without the offsetting one of increased taxes where values increase. In the United States, an optional alternative valuation date of one year after filing is available. The rule is generally accepted as worth while by taxpayers and tax collectors alike. Those who propose the alternative valuation date argue that probate is often not granted before three to six months after death, so that until then the executor has no chance to deal with the property. On a declining market this could have a disastrous effect. It is said that the date of death is an illogical date of valuation as this is the very day that assets are withdrawn from the market. Various time limits have been suggested, as well as the refinement that the sale date of an asset be used for valuation if the sale is made at arm's length and bona fide and within the time between the date of death and the optional valuation date allowed. The date of probate has also been urged. The argument against optional valuation dates is mainly concerned with administrative convenience. Such a rule involves delays and slows up administrative machinery. But we are not convinced by this; the number of taxable estates in Canada is not large, and the machinery for valuation already exists, so that the date upon which it is put into operation should cause no great problem. However, an alternative valuation date always favours the taxpayer; it cuts across the basic philosophy of an estate tax in that it looks entirely to the successors, and is designed for their benefit. Unless there are suitable safeguards, it could also open the door to widespread avoidance. However, the authors felt that they should take cognizance of the situation where an estate experiences an actual variation in value of one of its assets. They think that if a bona fide arm's length sale of property takes place within six months of death, the sale price should be taken as the value of the property, whether it has increased or decreased in value since the date of death. Otherwise, the fair market value at the date of death should be taken. This rule is not really in favour of either side. The six-month period is taken so as to coincide with the present date when liability to pay the estate tax arises, and this of course is also the reason for the six-month limit in the suggestion as to deduction of costs of sale.

> Summary 7. That if a bona fide arm's length sale of property takes place within six months of death, the sale price be taken as the value of the property; otherwise fair market value at the date of death is taken.

RATES

The tax on estates in Part I is computed by applying the rates in section 8 of the Act. The concept of progressiveness is not discussed here, but the authors accept it as being in accordance with the theory of ability to pay. The steepness of the graduation is not to be confused with exemption levels, about which something will be said later. The marginal rates in Canada start at 10% and increase by steps of 2% to reach a 54% maximum after $2,000,000. The marginal rates in the United States start at 3% and reach 49% at $2,000,000 with a maximum of 77% at $10,000,000. In the United Kingdom the rates are not applied to each marginal tax bracket but on the totality of the estate and range from 1% to 80% at £1,000,000.

The totality system is undesirable, involving as it must a marginal notch provision between each rate; also, theoretically, it is difficult to support taxing the first dollar of the estate at 1% or 80%, depending on the total value of the taxable estate. The authors have no comment to make either way on the constant marginal rate increases of 2%, or on the size of the brackets. The progressiveness of the system appears to be moderate, taking into account the exemptions. They do, however, suggest that the rate schedule should be extended upwards. In 1963-64, there were 72 estates of an aggregate net value of over $1,000,000, and that 1.6% of Canadian-domiciled taxable estates accounted for over 20% of the aggregate net value of all estates, and over 40% of tax assessed. 13/ It is these estates which have a considerable effect on revenue. The effective rate on an estate with a taxable value of $3,000,000 is 45%, which is moderate in the absence of any other tax on capital. Also, note that the top marginal rate and the effective rate at high levels is lower in Canada than that in most countries which levy taxes on death. 14/ There is no reason for not suggesting an extension of the rate schedule at the upper limit to keep revenues at about $100 million or 2% of total federal tax revenues. There is no principle by which to set upper limits or degrees of progressiveness, so to follow the present rate schedule closely, it is suggested that the 52% rate bracket be extended to $2,100,000, and that further rate brackets be added, of 54% to $2,400,000, 56% to $2,700,000, 58% to $3,000,000 and 60% thereafter. If it were wished to temper the effect this would have on very large estates, it could be provided that no estate pay tax of more than 50% of its aggregate taxable value; 15/ some have advocated that the state should not participate with the successors beyond one half of an estate. This provision would come into effect with the recommended rates where an estate's taxable value is just over $4,250,000.

Summary 8. That the marginal rates be extended to 60% at taxable value of $3,000,000, with a possible provision that no estate pay tax of more than 50% of its aggregate taxable value.

DEFINITION OF "CHARITY"

All charitable gifts may be deducted from the aggregate net value of an estate, thereby reducing its tax burden. It would appear that what was provided in a spirit of altruism has become a fertile basis of imaginative schemes for reducing tax. However, this Study does not suggest the repeal of the charitable gift provisions as this would destroy the good achieved thereby in order to prevent the mischief. There is no validity in abolishing a beneficial provision because it operates badly; the solution is, rather, to improve its operation. Nor does this Study suggest a percentage limit on deductible charitable gifts. The authors understand that several organizations regard large donations from large estates as their life blood, and if redistribution is a basic aim of the Act, charitable gifts are one of the most direct forms of its implementation.

Whether a gift is deductible as charitable has come to depend upon some words of Lord Macnaghten which include the vague phrase "other purposes beneficial to the community". 16/ The authors seek for certainty in tax law, and this is hardly the case when the Royal Commission on the Taxation of Profits and Income in the United Kingdom says in its final report that "...judges have declared themselves baffled by the task of deciding according to law what is and what is not a charity". 17/ The authors therefore would adopt the recommendation of the United Kingdom Royal

Commission providing a statutory definition of charity for tax purposes. This would be: "The relief of poverty, the prevention of distress, the advancement of education, learning and research, and the advancement of religion". 18/

Summary 9. That a definition of charity for tax purposes as set out above, be enacted.

GIFTS TO CHARITY

Many of the techniques of utilizing the charitable gift exemption to avoid payment of estate tax and yet ultimately effect some purpose other than the charitable object, have as their pivotal point the fact that the assets of a deceased can be filtered through to a recipient other than a charity on the dissolution of a charitable organization, the gift and the charitable organization having both been within the provisions of section 7(1)(d). In the absence of provincial legislation as to the disposition of the assets of a charitable organization which is being dissolved, the common law rule applies, which is that, where a gift is made to a charity for a special purpose, on dissolution of that charitable organization, the gift will not be applied cy pres (i.e., for a similar purpose), but will be returned to the donor or his estate, and the will of the testator can provide for disposition of such after-death-acquired assets to whomsoever it wishes, such property not being taxable in that it is not "property passing on the death". A Canadian court has considered the word "absolute" in section 7(1)(d), and has emphasized the distinction that it does not mean that the recipient must have an interest of unlimited extent, but that it is the vesting which must be irrevocable and undefeatable, to come within the word "absolute" in the section. 19/ The addition by amendment of the words "and indefeasible" in section 7(1)(d) was said by the court to add nothing to the meaning attributed to "absolute", in that the vesting must already be irrevocable and indefeasible (which, in the Halley Estate case 19/ it was not); but it may be that to give the added words import, the first meaning, given above, of the word "absolute" is now also covered. Thus, the recipient may now also have to have an interest of unlimited extent for the gift to be exempt. 20/ The authors, however, are convinced that an amendment to section 7(1)(d) is necessary to prevent avoidance schemes based on the technique of dissolution, in the event that the 1960 amendment has not plugged the loophole. This situation is similar to that encountered with exempt institutions. They also believe that a further avoidance technique exists whereby a charitable foundation is set up by the testator, who wills capital to it, and provides that the income be used for charity. The decedent's spouse, or another person he intends to benefit, is then paid a salary sufficient to effectively draw off the capital.

The first problem outlined above could be blocked by a provision that only gifts to those charitable organizations which have a provision in their by-laws specifically providing that on dissolution or failure of the charity, the charitable funds shall be applied cy pres, shall qualify. This would not be an interference with provincial jurisdiction over property and civil rights, in that it would not prevent gifts being made to charitable organizations whose by-laws do not contain such a provision; such gifts would merely not be tax-exempt. As to the second problem, the matter is more difficult to control, as there may be occasions when a relative of the deceased is a bona fide paid employee of the charitable organization benefited, or when the drawing off of capital occurs spasmodically or some considerable time after death. The only effective block to this involves a method which must be combined with adequate supervision of charities; that is, to provide that if it is proven that funds of a charity are being drawn off to the benefit of a relation of a donor to the charity, and in the Minister's opinion it is being done with the intention of circumventing the provisions of the Estate Tax Act, then the amount so donated can be brought back into the estate and the estate re-assessed, even after four years, on the ground that such intentional circumvention is deemed to be a misrepresentation or fraud within the meaning of those words in section 12(5). The authors do not hesitate to suggest a ministerial discretion provision (hedged by suitable appeal provisions) in this situation, in that section 7(1)(d) is a provision for the benefit of taxpayers, and use of it should be strictly controlled and ingenious abuse prevented.

> Summary 10. That charitable gifts only be tax-exempt under section 7(1)(d) in those cases where the recipient charitable organization has a provision specifically providing that on dissolution or failure of the charity, the charitable funds shall be applied cy pres.

> Summary 11. That the Minister be empowered to deem that the provisions of the Act are being circumvented in those cases where it is proven that funds of a charitable organization are being depleted to the benefit of a relation of the donor to the charitable organization; and that in such cases, the gift be brought back into the estate and the estate re-assessed pursuant to the provisions of section 12(5)(a)(i).

EXEMPTIONS

Many submissions were made to the Royal Commission on the subject of personal exemptions—a subject which attracted much attention when the Estate Tax

Bill was introduced into Parliament. The present personal exemptions vary with the size of the decedent's family, but not with the extent of the benefits members of the family receive under the will. The authors consider that it is unrealistic to allow personal exemptions when the deceased may leave his entire estate to, for instance, his mistress, who will then get the benefits of the exemptions statutorily provided in respect of his wife and children. It is appreciated that provincial statutes usually see to it in such cases that the widow and children are provided for out of the estate, and that most of the Income Tax Act personal exemptions are similarly provided without reference to actual expenditures on the dependants in question. However, we find no acceptable rationale in an exemption system which is intended to provide tax-free money to dependants, and which, nevertheless, is unrelated to the sum actually bequeathed to the dependant.

Secondly, the authors see no reason why any exemption should be allowed for an estate where there are no qualifying dependants. At present, such an estate has a $40,000 exemption. In so far as the exemptions are intended to benefit dependent relations, this is inconsistent with principle, and should be abandoned. However, it is also suggested that the definition of qualifying dependants be extended to cover any person related to the deceased by blood, marriage, or adoption and dependent on the deceased. 21/ It will be noted that we have had reference to section 26(1) of the Income Tax Act here, for it is felt that much the same end is being sought.

A third criticism is that the present exemption system differentiates between widows and widowers, healthy widowers and infirm widowers, and situations where there is a spouse or no spouse surviving. The amounts applicable in each situation have no logical basis that the authors can discover, either considered separately or in relation to each other. A search for a logical basis for exemptions has led us to believe that there is a social obligation on the deceased to provide to the extent that he can for the requirements of his dependants. The taxing statute should not unduly interfere with this. The extent of the interference should not vary, whether the dependant is a widow or widower, healthy or infirm. Possibly this should have some effect on taxes on income, but not here, for the capital will probably be used to provide the dependant with assets of a capital nature regardless of the sex or health of the dependant.

A fourth criticism is that the exemptions as at present arranged benefit wealthy estates more than the medium ones, as is found in any progressive tax rate system. The $10,000 exemption for a child benefits an estate to the extent of $1,000 or $5,400, dependent on whether the tax is at a marginal rate of 10% or 54%. It will be seen that this is not merely a matter which can be resolved by varying the steepness of the tax rate structure, as the variation in effect is experienced because of differences in dependants, not differences in size of estates. If the exemptions are to make tax-free money available for basic amenities, the amount should be the same, whatever the size of the estate. The argument that the widow of a wealthy man should receive more is answered by the fact that, in fact, she does receive more "after-tax" money; it is merely the tax-free amounts which should remain constant. The authors have considered various solutions, and are impressed with the tax credit system. They feel that once a certain exemption figure has been decided on as suitable to support a bereaved relative, that amount of tax-free money should be equally provided in respect of all estates, regardless of size. 22/

An alternative treatment of personal exemptions 23/ is as follows: an exemption system whereby exemptions increase in benefit by reference to the top applicable marginal rate is incompatible with the concept of the provision of tax-free money to dependants for the provision of basic amenities which would otherwise have been provided by the deceased. However, it is not theoretically essential that we move to the other end of the scale and permit constant amounts by way of tax credit, for a counter consideration is the fact that expenditures on basic amenities and necessaries increase with higher class living. A compromise would be to relate the benefit to the average effective rate, which increases the larger the estate, but not as steeply as it does under the present system. To effectuate this, the aggregate value of the estate before exemptions is assessed by applying the rates set out in section 8. The average effective rate is struck, and this rate is then applied to the aggregate value of the estate minus exemptions—that is, to the taxable value. Thus, on an estate with an aggregate value before exemptions of $1,000,000, the tax is $331,500 for although the top applicable marginal rate is 44%, the average effective rate is 33.15%. This rate is applied to the taxable value of the estate which may be $950,000 because of a $50,000 exemption. Thus, instead of that exemption benefiting the estate by $22,000 (as it does now) it only benefits it by $16,575. Although this would be higher than the benefit of exemptions at the lowest rates, it is not so extreme as in the present system.

If this system were to be adopted instead of the tax credit system, we would have to suggest exemption figures. Starting with the widow and widower, it was considered whether such a survivor should have an exemption of a lump sum plus an amount for each year that the survivor was under 75.

Thus, a widow of 70 would have \$20,000 plus five times \$1,000, or a total of \$25,000, while a widow of 25 would have \$20,000 plus fifty times \$1,000 or a total of \$70,000. It is felt, however, that widows should be taxed as a class and not dissimilarly treated. A young widow has some advantages over an old widow, and if we are to take age into account, so should other characteristics, such as private means, or remarriageability, be taken into account. As to children, however, the authors would be prepared to suggest an exemption which reduces as the child approaches the end of his dependency. Also, a child, even when over 25, should be treated in a privileged position vis-à-vis a stranger. It is believed that those who are related by blood, marriage or adoption and dependent by reason of age or infirmity should have some exemption, provided, as in all other cases, that they are a beneficiary of the estate. One exception to this should be that where a child who is dependent by reason of age is not bequeathed property, the exemption to which that child would be entitled should be available to the widow or widower over and above the spouse's exemption.

The following exemptions are suggested where property has been bequeathed to the following persons:

Property bequeathed to:

(1) Widow or widower--\$75,000.

(2) Child--\$20,000 up to 20 years of age, then reducing by \$2,000 each year to \$10,000 at 25, and \$10,000 thereafter. Up to 25, the child's exemption is added to the widow's or widower's exemption to the extent that property bequeathed to the child is less than the permitted exemption.

(3) Those related by blood, marriage or adoption and both dependent and under 25 to be treated as children of the deceased.

(4) Those related by blood, marriage or adoption and dependent by reason of infirmity—$20,000.

(5) Where there is no surviving spouse, children of the deceased to be entitled to 1 1/2 times the exemption permitted under (2).

(6) Grandchildren taking property by representation share the exemption to which their deceased parent would have been entitled.

The authors have however, reached the conclusion that since the fourth criticism (set out above) of the present exemption system applies, though to a lesser degree, to the above outlined exemption system, they must therefore suggest a tax credit system, the beneficial effect of which is constant, regardless of the size of the estate. A similar initial procedure is followed, in that the aggregate value of the estate is assessed by applying the rates set out in section 8, and the average effective rate is then struck. That pro rata part of the tax assessed applicable to each bequest is then reduced by the following tax credits.

Property bequeathed to:

(1) Widow or widower—tax credit of $15,000.

(2) Child—tax credit of $5,000 for children under 21, and $5,000 minus $1,000 for each year the child is over 21 up to 25, and $1,000 thereafter. Up to age 25, the child's tax credit is added to the widow's or widower's exemption to the extent that property bequeathed to the child attracts tax of less than the permitted tax credit.

(3) Those related to the deceased by blood, marriage, or adoption and both dependent and under 25 to be treated as in (2).

(4) Those related to the deceased by blood, marriage, or adoption and dependent by reason of infirmity—tax credit of $5,000.

(5) Where there is no surviving spouse, children of the deceased to be entitled to 1 1/2 times the tax credit permitted under (2).

(6) Grandchildren taking by representation share that tax credit to which their deceased parent would have been entitled.

Note that the tax credits are only applicable if a bequest has been made to the appropriate dependant; if the bequest attracts tax of less than the tax credit, the balance of the credit is not available to the estate. Thus, if the pro rata share of the tax applicable to the widow's bequest is $14,000, the tax credit applicable to the estate's tax is restricted to $14,000.

Another problem is that raised by the community-of-property concept. It is not thought that this concept should be extended to all provinces. However, if the family unit was to become, for all tax purposes, the tax unit, then this would in effect eliminate the problem (since it is assumed special treatment would be afforded all inter-family transactions).

Summary 12. That a tax credit system as set out above be implemented.

BASIC EXEMPTION

It was also considered whether the exemption of estates with an aggregate net value of $50,000 or less is unrealistically low. In the fiscal year 1963-64 over 55% of Canadian-domiciled taxable estates had an aggregate net value of between $50,000 and $100,000. The tax assessed (before tax credits and re-assessments) was $8 million, or less than 6% of total tax assessed on Canadian-domiciled estates (before tax credits and re-assessments). 24/ We do not estimate the reduction in costs effected by halving the number of estates which would be reviewed, but the saving would presumably be a considerable proportion of the $8 million. On the other hand, Summary 12 would put personal tax credits on the basis of property actually bequeathed to the person in respect of whom the exemption is given. It is doubted whether there is any place for a "basic" exemption of $100,000 in such a system, for it would mean that the man with $100,000 could bequeath it to his wife and one child and pay no tax or to his mistress and pay no tax. One purpose of Summary 12 was to cure this fault. Furthermore, if the Department has to value an estate to determine whether it is taxable, it does not seem too great a next step to proceed to assess that estate. Submissions to the Royal Commission have suggested raising the basic exemption by exempting estates with an aggregate net value of $100,000; others have advocated a "true" exemption of $100,000—that is, a nil rate on up to $100,000 of all estates. The revenue effect of this last would be very great, and cannot be supported. The authors are however, prepared to suggest, as an administrative measure, that no estate of a value of $100,000 or less be liable to pay estate tax. Note that this is not a "true" exemption, so that an estate of over $100,000 is liable to tax on the whole estate, that tax being reduced by the appropriate tax credits. A notch provision similar to that which we now have should be provided.

> <u>Summary 13</u>. That estates with a value of $100,000 or less be not liable to tax; and that a notch provision be provided for estates immediately above a value of $100,000.

QUICK SUCCESSIONS

The quick succession provisions create some of the severest administrative problems in the Act, and the authors have investigated both the rationale of the rules and their application. Subsidiary problems are dealt with in the Technical Appendix.

Quick succession rules are an attribute of an acquisition tax rather than a mutation tax, in that they look to the characteristics of the successors rather than to those of the estate. Nevertheless, the harshness of this aspect of an estate tax system calls for some amelioration, and once one has accepted the anomaly of providing personal exemptions or credits in an estate tax with the purpose of benefiting relatives, one must also accept some quick succession provision so that those benefits are not cancelled out by the imposition of full estate tax twice in a short time. The imposition of a tax on capital at too frequent intervals is undesirable and contrary to the "benefit" theories which, to some extent, underlie death taxes. The authors therefore think that some quick succession provision must be retained, and they have looked for a method whereby the administrative difficulties might be relieved. The main problem is centred on the identification of property, for if the property in the transferee's estate was not that in respect of which tax was payable on the transferor's death, it must at least be identifiable as having been exchanged or substituted therefor. This is administratively difficult, and also discriminates against one who uses his bequest at all adventurously. If there were no identification requirement, there would, at first sight, be difficulty in determining the extent and value of property retained from a bequest in the estate of the transferee. However, the United States and Australian quick succession methods have been examined with interest and it is believed that these difficulties can be overcome by the following plan. Let the transferee's estate be deemed to have retained a percentage of the bequest from the transferor, the value of the bequest being that ascribed to it in the transferor's estate. The percentage retained by the transferee is deemed to decrease with the effluxion of time; as that effluxion of time also increases the benefit to the transferee, or his enjoyment of the property bequeathed to him, the percentage credits presently found in section 33 should then be applied to the deemed retained value.

Summary 14. That the transferee's estate be deemed to retain transferred property to the extent of the following percentages of its value in the transferor's estate:

100% if the transferee dies within one year of the transferor; 50% of the deemed retained property will be deductible from aggregate net value.

90% if the transferee dies within two years of the transferor; 40% of the deemed retained property will be deductible from aggregate net value.

80% if the transferee dies within three years of the transferor; 30% of the deemed retained property will be deductible from aggregate net value.

70% if the transferee dies within four years of the transferor; 20% of the deemed retained property will be deductible from aggregate net value.

60% if the transferee dies within five years of the transferor; 10% of the deemed retained property will be deductible from aggregate net value.

TAX CREDITS

Section 9 of the Act provides for provincial tax, gift tax and foreign death tax credits, applicable in that order; gift tax credits are considered elsewhere. 25/ The tax credit in section 9(1) is determined wholly on the basis of situs, rather than on the basis of actual payment of provincial duties, which was the case under section 12 of the former Dominion Succession Duty Act. Whether a prescribed province does in fact tax the property is now immaterial, and situs is determined, not by looking to the law by which the provinces are bound, but by reference to the statutory situs code provided in the Act. Three possible situations may arise:

(1) A tax is imposed by a prescribed province, and a tax credit is allowed under section 9(1). Here the provision functions properly.

(2) No tax is imposed by a prescribed province, but a tax credit is given nonetheless under section 9(1). 26/

(3) The province levies a duty on property not situated in that province according to the provisions of section 9(8) of the federal Act, and therefore is not entitled to the federal credit. Thus, the owner of fully registered bonds of the Province of Manitoba dying domiciled in Ontario will pay both federal and Ontario duties, with no federal credit.

The authors are aware of other anomalies, such as that which arises when two successors are joint tenants, only one being resident in a prescribed province. Also, a transmission in a prescribed province of property situated outside Canada by common law rules, but situated in a non-prescribed province by virtue of section 9(8), appears to give rise to triple taxation. It is argued that the province of situs should have priority as to revenue, and therefore a federal credit ought not to be given in respect of a tax imposed by another province, which province would normally have had to abate in favour of that other province's prior right, had it not been for the existence of the tax rental agreements. If both provinces levied succession duties, one would give a deduction or credit in respect of the tax levied by the other. The Department regards itself as a collecting agent for "renting" provinces, and does not feel it should have to give a credit for what the prescribed province should—and otherwise would—give a credit. This argument ignores the fact that it is the federal situs rules which, when inconsistent with the common law, give rise to the points of conflict. For a credit is only given for provincial tax "payable" by virtue of the federal situs rules in section 9(8), rather than by virtue of what is "payable" by virtue of the common law situs rules, by which the provinces are bound. The authors have considered several suggestions including the substitution of the words "outside the prescribed provinces" instead of "outside Canada" in section 9(1)(a)(i)(B), but this only resolves situation (3) above. The only practical solution is to return to the system of allowing a provincial tax credit only when provincial taxes are actually paid. This test is purely practical, and would bring section 9(1) more in line with section 9(2) and 9(3). It also appears that section 9(8) could be greatly simplified.

Summary 15. That the provincial tax credit be applied where provincial death duties are paid.

SITUS

A combination of common law situs rules developed in the 19th century and ill-equipped to deal with modern business factors in Canada, and a constitutional limitation on the provinces to legislate with respect to situs, 27/ has led to a mass of technical situs rules in the federal Act. There are two situs codes, each to deal with different problems. Therefore, the authors have:

(1) Situs rules in section 9(8) for application of the provincial tax credit.

(2) Situs rules in section 38, which serve two purposes:

(a) for application of the foreign tax credit;

(b) for inclusion of property in estates of non-Canadian-domiciled decedents.

(3) Common law situs rules, by which the provinces are bound.

(4) Situs rules in various death tax conventions with other countries which modify (2) and (3).

It is not intended to discuss this problem in detail here. We recognize that the federal authorities are in the unenviable situation of having to decide situs for purposes of federal tax, situs for purposes of provincial abatement and tax sharing, and situs for purposes of foreign credits. In fact, as matters stand, we can see no solution, merely ameliorations. As already suggested, a return to a credit for provincial death taxes actually paid is feasible, and it would resolve many of the problems. The main difficulty has always been with shares, and it appears that the complicated provisions of section 9(8)(d) are necessary to counter the ingenuity of taxpayers. 28/ It is further suggested that the two situs codes could approach conformity with the common law in certain areas. As a first example, it appears that a specialty debt, such as a mortgage, found in Ontario, will be taxed by Ontario under the common law rule, but no tax credit will be available against the tax levied by the federal authority if the debtor ordinarily resides elsewhere. Furthermore, if the land concerned is to be found outside Canada, in a country where mortgages are regarded as immovable and there is no mortgage document deposited there, the foreign country will probably also tax, without any credit being allowed against the federal tax. As a second example, if a debtor resides in two provinces, and a reference to a simple contract to localize the debt places the debt at common law in Ontario, the federal authority may yet determine that the debtor is "ordinarily resident" in Alberta. As a third example, a debt of a Dominion corporation may be situated in a foreign country by the common law (being enforceable there), in Ontario by section 38(c), (since the company is incorporated at Ottawa), and in a non-prescribed province by section 9(8)(b)(i) (the head office of the company being located there). Also note that the rule in section 9(8)(c) for specialty bonds, debentures and government-guaranteed securities conforms to the common law rule, while sections 38(c) and 38(d), dealing with the same subject matter, do not. As to partnership property, the statutory rule, by simplifying the common law rule, ignores the possibility of several distinct businesses being carried on by the partnership in several jurisdictions. The same comments apply to goodwill. There appears to be no good reason for this. In each of the above situations, a closer approach to the common law rules is possible.

It is also necessary to draw special attention to section 9(8)(e), which is possibly an indication of the legislative approach to situs problems. Where a statute is not express, the rule at common law will survive. Until the amendment in 1960 which introduced section 9(8)(e), the common law rules dealt with residual situs problems, and they still do in section 38, where there is no residual statutory rule. The reason for the difference in treatment is illogical, and it appears that the choice of domicile as the residual test is arbitrary and appears to be a deliberate attempt to conflict with the applicable rule at common law, such as in the case of goods on ships, where the common law situates them where the bill of lading can be effectively transferred. The authors are even more concerned by the scope of this section, for if the situs of property "cannot with reasonable certainty be identified", then instead of resolving the problem by reference to a court of law, the arbitrary decision is made that the property is deemed to be situated where the deceased was domiciled. Section 9(8)(e) has no place in an equitable tax law. 29/

> Summary 16. That situs rules be made to conform more closely to common law rules where possible, and that section 9(8)(e) be repealed.

PAYMENT

The administration sections of the Act dealing with certain aspects of returns, collection, enforcement, penalties and consents, are considered in the Technical Appendix while here we deal with problems of payment and liens.

An executor is required by section 14(3) to pay tax on property which does not pass through his hands but only to the extent that he can reimburse himself from property under his control. He is given, by section 14(4), a right of action against the beneficiary to recover the tax so paid. It is possible that this right of action is not "in relation to" the "raising of money by any mode or system of taxation" 30/ as the tax has already been levied. Section 14(4) purports to adjust rights as between the parties, and may run contrary to a provision in the will which makes the executor liable to pay death taxes on *inter vivos* gifts out of residue. In those cases where recipients of *inter vivos* gifts have been held liable to bear succession duties and reimburse the executor, it has always been the terms of the will which determined the matter. 31/ It would therefore appear that any federal legislation adjusting rights of parties may be an <u>ultra vires</u> interference with testamentary powers and with the exclusive provincial right to legislate with reference to property and civil rights. 32/ It is not only section 14(4) which is open to this criticism, but also section 14(2), which vests in a successor the rights of a surety, one of which is a right over against the principal debtor, here, the executor. The nature and extent of the successor's rights vis-à-vis the executor should depend on the will and be determined according to the proper law of the succession; section 14(2) goes beyond imposition of and liability for tax, and attempts to regulate where the burden shall fall. When the Act goes beyond determining who is accountable to the Crown for payment of the tax and attempts to regulate how the burden of the tax is to be borne, it would appear to be <u>ultra vires</u>.

In this connection, the authors have also considered section 18(1). This section, with sections 13 and 14, would appear to be part of a federal attempt to impose on the proper law of successions some federal regulation of liability, not just to pay, but to bear the burden of, the tax. If section 18(1) is merely rendering certain the nature and extent of the executor's liability to the Crown, then it is competent legislation, but this task would appear to be done by section 40. Also, if section 18(1) is merely establishing priority, this would appear again to be competent; but section 18(1) cannot make the tax payable by the executor a general debt of the estate for all purposes, or a charge against the residue regardless of testamentary provisions, and if it does do more than establish the nature of the tax and its priority, and attempts to override a testamentary direction or, if the will is silent, or there is an intestacy, bringing into operation the proper law of the succession, then it is part of the fabric of the payment system which may be ultra vires. They find a further part of this fabric in section 44, for if an executor withholds property from a successor under section 14(4) to pay tax on his behalf by virtue of section 14(3), section 44 purports to deny the successor a right of action against the executor even if it was done in violation of a testamentary direction to the executor to pay all death taxes, including those on inter vivos gifts, out of residue.

The authors have hesitated to call the whole payment system of the Act ultra vires, for it has been unchallenged in this respect during five years of operation. Also, this Study should not take on an exclusively judicial function. However, note one widespread practice which denies the beneficial interpretation that the sections discussed above merely establish the nature and priority of the taxes without presuming to shift the burden of tax from the beneficiaries to the residue. If the beneficial interpretation were correct, there would be no need to change wills, as the Act would not interfere with the rights set up therein. But it was widely accepted, in 1959, that wills would have to be altered in certain cases to ensure that the tax burden fell where it was intended to fall. This would appear to be a tacit admission that the Act did so interfere, and it is inferred from this that the payment system is possibly ultra vires.

A further reason has led to a search for an alternative, and that is that there appears to be no way of resolving the conflict between the terms of the will and the statute when each imposes sole liability to pay the tax. Under section 14(1)(b), if a successor receives exclusively property which did not pass through the executor's hands, he is solely liable. If, for some reason, the Department could not recover from the successor, could it rely on a testamentary direction that the executor pay the tax on such property? Conversely, could the executor defy that testamentary direction and refuse to pay the tax on the ground that the Act does not render him liable to do so? A specific solution to this problem is suggested in the Technical Appendix, but the problem itself also spotlights the conflict between the Act and the proper law of the succession.

For these reasons, and for the more general one that one would prefer to see a payment system more closely related to the actual obligations and eventual burdens stipulated by the proper law of the succession, the authors have considered a system by which the Act would make the following persons liable to pay tax:

(1) Where the will stipulates who is to pay estate tax, or a portion thereof, or the estate tax on a specific piece of property, those persons are to be primarily liable under the Act for its payment.

(2) Where the will is silent, or where there is an intestacy, those persons designated by the proper law of the succession as those to bear the burden of estate tax shall be primarily liable for its payment.

(3) Where any person liable under (1) or (2) is not the executor of the estate, the executor shall also be liable, but merely as surety, for the payment of the estate tax.

The authors consider that the above will not conflict with the proper law or the testator's intentions. Nor do they believe it would have the effect of changing the tax from an estate tax to something else. The essence of the estate tax is not that it is a tax paid by the executor as opposed to one paid by the beneficiaries—that is, merely the distinction between an indirect tax and a direct tax, for, in the end, the burden is always borne by the same person, the beneficiary. The distinction between an estate tax and an inheritance tax is that the first is calculated by reference to the value of the estate, rather than by reference to the size of the bequests and the relationships of the beneficiaries to the deceased; the payment system suggested does not cross the line of this distinction.

Summary 17. That a new payment system be developed along the following lines:

1. Where the will stipulates who is to pay estate tax, or a portion thereof, or the estate tax on a specific piece of property, those persons are to be primarily liable.

2. Where the will is silent, or where there is an intestacy, those persons designated by the proper law of the succession to bear the burden of estate tax are to be primarily liable.

3. Where any person under 1 or 2 is not the executor of the estate, the executor shall also be liable, as surety.

LIENS

The lien against realty provided by section 43 exists as long as any estate tax is payable, and applies, without the necessity of registration or notice, to all legal, equitable, registered and unregistered interests in land. The Minister may, but need not, register a caution of lien against the land in the appropriate registry. Section 43(3), which provides for federal-provincial co-operation to prevent a transfer of land without a section 47 consent, is a dead letter, save that British Columbia 33/ requires the filing of a section 47 certificate of discharge. As section 43(3) is largely ineffective, the authors have considered whether section 43 should not be changed. The lack of a mandatory requirement on the Minister to register a caution means that a bona fide purchaser may never become aware of the lien, and, despite prior registration of transfer to that purchaser, the lien takes priority; this conflicts with the elements of a land registration system, and, in so far as it robs the registration system of efficacy, it may well be an interference with provincial property and civil rights legislation. Furthermore, because of section 53 which prohibits the unauthorized communication of information by departmental employees, it would appear that technically the prospective purchaser cannot even discover from the Department if all taxes are paid. In considering what should be done with the lien provision, it was noted that the United Kingdom procedure is such that on a conveyance subsequent to the charge for duty, the charge is overridden, and the lien shifts to the proceeds of sale or other property derived from the conveyance.

Summary 18. That it be mandatory that the Minister register a lien in those provinces which do not take steps to comply with section 43(3); provided that the lien shift to the proceeds of sale where land is sold to a bona fide purchaser.

REFERENCES

1/ See A. G. v. Milne, [1914] A.C. 765, 83 L.J.K.B. 1083; Nevill v. Inland Revenue Commissioners, [1924] A.C. 385, 93 L.J.K.B. 321.

2/ See Cowley v. Inland Revenue Commissioners, [1899] A.C. 198, 68 L.J.Q.B. 435, per Lord Macnaghten at p. 212. (A.C.) p. 442 (L.J.Q.B.).

3/ Public Trustee v. Inland Revenue Commissioners, [1960] A.C. 398, [1960] 1 All E.R. 1.

4/ It was also assumed, when writing the Study, that the Department would not apply the English cases decided under section 2(1)(d) of the 1894 Finance Act which taxed the interests which arose or accrued under inter vivos trust settlements upon the death of the settlor even where the settlor had irrevocably parted with, and retained no control over, the trust assets. However, in 1962, section 3(4a) was introduced (and made retroactive to 1959) making the Canadian sections 3(1)(j) and 3(4a) similar to the English sections 2(1)(d) and 28 which tax the whole of the value of the interest (not merely the extent by which the interest was increased by the death). It then became clear (see "Inter Vivos Trusts—The Implications of Parker vs. Lord Advocate", Canadian Tax Journal, Vol. XIII No. 2, March-April, 1965) that the purpose of the amendment was to enable the Department to apply the English jurisprudence in Canada and to tax such interests in full upon the settlor's death. This intention is inconsistent with the Department's policy of not taxing property which passes on the death of a life tenant, but by Summary 1 it is proposed that such policy be changed. In view of the blatant avoidance techniques recently evolved in England—(See Morgan v. I.R.C. [1963] 1 All E.R. 481, Ralli Brothers Ltd. v. I.R.C. [1966] 1 All E.R. 65, Public Trustee v. I.R.C. [1966] 1 All E.R. 76, Re Kilpatrick's Policies Trusts [1966] 2 All E.R. 149 and Re Holmden's Settlement Trusts [1966] 2 All E.R. 661) Summary 1 should be extended to suggest that all such interests are taxed upon the relevant death.

5/ See Finance Act, 1894 (57 and 58 Vict. 30), section 2(1)(b).

6/ Report of Proceedings of the 17th Annual Tax Conference, Canadian Tax Foundation, 1963, p. 336.

7/ Report of Double Taxation, submitted to the Financial Committee of the League of Nations, Geneva, 1923, at p. 18.

8/ "Political Allegiance No Longer Forms an Adequate Test of Individual Fiscal Obligation." Report on Double Taxation, supra, footnote 13 at p. 19.

9/ Sections 36, 37(2).

10/ Canada-U.S.A. Estate Tax Convention, as shown in the Schedule to the Canada-U.S.A. Estate Tax Convention Act, S.C. 1960-61, c. 19.

11/ Canada-U.S. Convention, Art. IV(2).

12/ See Colwyn Report of the Committee on National Debt Taxation, 1927, Appendix XX, para. 19.

13/ 1964 Taxation Statistics, Part Two, Section III, Table 2A.

14/ Top rates in other countries include: Netherlands 54% (marginal rate); Germany 60% (marginal rate); Austria and France 60% (effective rate); Japan 70% (marginal rate); Belgium 72.6% (marginal rate); United States 77% (marginal rate); Italy and United Kingdom 80% (effective rate). Source, Taxation in Western Europe 1963, F.B.I. Taxation Studies, and an Outline of Japanese Tax, 1963, Tax Bureau Ministry of Finance and the Internal Revenue Code, U.S.A.

15/ This could be done by repealing s. 9(5) which was designed to prevent the 50% notch provision for small taxable estates under s. 9(4) from applying to very large estates.

16/ The Commissioners for Special Purposes of the Income Tax v. Pemsel, [1891] A.C. 531 (H. L.) at p. 583, or 3 T.C. 53 at p. 96.

17/ Op. cit., Cmd. 9474, p. 56.

18/ Final Report of the United Kingdom Royal Commission on the Taxation of Profits and Income, Cmd. 9474, p. 57.

19/ See Halley Estate v. M.N.R., 63 DTC 1090, [1963] C.T.C. 108; affirmed in the Supreme Court of Canada without further reasons; see 63 DTC 1359. Also see Towle Estate v. M.N.R., 65 DTC 5042; [1965] C.T.C. 74.

20/ See S.C. 1960, c. 29, s. 4(1) which, inter alia, added the words "and indefeasible".

21/ The rule suggested for "qualifying dependants" would be:
(a) a surviving spouse and children under 21 are deemed to be qualifying dependants.
(b) children over 21 and any other relatives by blood, marriage or adoption are dependants only if they qualify as dependent for purposes of s. 26(1)(c) and (d) of the Income Tax Act and s. 1000 of the Income Tax Regulations.

22/ We recognize that if a tax credit system is adopted, it would be reasonable to also look at the rate structure, because of the incidental effect on progressiveness of such a system.

23/ Which arose from discussions with the Ontario Tax Committee and The Quebec Royal Commission on Taxation.

24/ 1964 Taxation Statistics, Part Two, Section III, Table 2A.

25/ See the Gift Tax study, a published study prepared for the use of the Royal Commission on Taxation.

26/ For example, s. 9(8)(d) gave rise to this situation, before two lengthy and complicated amendments were made in 1960 and 1962. (S.C. 1960, c. 29, and S.C. 1962 (2nd Sess.), c. 5.)

27/ The King v. National Trust Co., [1933] S.C.R. 670, [1933] 4 D.L.R. 465.

28/ See however, the views expressed in Leckie v. M.N.R. 66 DTC 5237; [1966] C.T.C. 310. Note also that situs of shares for tax purposes is not situs for execution purposes; Hunt Estate v. M.N.R., 66 DTC 5322; [1966] C.T.C. 474.

29/ Note that in the one case where section 9(8)(e) has been applied, MacRury Estate v. M.N.R., 66 DTC 575, [1966] 41 T.A.B.C. 426, it resolved the case in favour of the estate.

30/ B.N.A. Act, 1867, s. 91(3).

31/ See Re Schiff, [1949] O.W.N. 169, [1949] 2 D.L.R. 93; Re Reading, [1940] O.W.N. 9, [1940] 1 D.L.R. 387, and on the other side, Re Sanderson Estate, [1949] 1 W.W.R. 1021; Re Poulin, [1944] 1 D.L.R. 756 and Re Snowball, [1942] S.C.R. 202, [1942] 2 D.L.R. 209.

32/ See Loffmark Estate Taxes, The Carswell Co., 1960, p. 468; "... it does not appear to be open to the Canadian Parliament to say whether the residue of an estate must suffer the reduction or whether the tax is to be apportioned on some other basis among the successors. It is submitted that once the demands of the Crown in right of Canada have been met, the basis on which the interests of the respective successors is to be invaded is a matter to be decided in accordance with the proper law governing the succession." Note, however, the distinction drawn by Cattanach, J., in The Queen v. Inter-Provincial Commercial Discount Corporation Limited, [1966] C.T.C. 105; 66 DTC 5107, between matters "affecting" and matters "in relation to" property and civil rights. There, certain provisions of the Excise Tax Act were held to be intra vires as legislation necessary to secure effective collection of the tax.

33/ And now also Saskatchewan pursuant to Regulation 12B as amended by P.C. 1965-2149.

CHAPTER 3—ALTERNATIVES

The authors now turn from their detailed consideration of the Act to review possible alternative modes of taxation of property at the death of its owner. They feel obliged to do this because they are not convinced that the estate tax is a tax that is suitable or equitable in Canada today. It is a tax on the ill-advised wealthy, and in Chapter 2 it was sought to broaden the scope of the tax so as to include in its ambit at least those who presently accumulate wealth but arrange their affairs so as to minimize the impact of taxes at death.

A first query was whether there need be a death tax at all. Any single argument for a death tax is of little individual merit. For instance, it cannot be said that the tax raises much revenue. Nor can the argument that it is beneficial because it breaks down accumulations and perpetuations of wealth be carried too far, for a point made against the tax has always been to the very opposite effect, namely, that it causes the sale of small businesses. As to the argument that it affects redistribution, the authors have some difficulty in equating a tax on transfers with that theory, as in its broad sense redistribution, being relative to revenue, is minimal when a tax only raises approximately one hundred million dollars, and in its narrow sense, a tax on a transfer can be a fetter on redistribution. Where the tax has generous exemptions for transfers to the close family, the arguments that accumulations and perpetuations of wealth are broken up and that there is redistribution are only true in a limited sense, as all that happens is that the wealth is in the several pockets of the family instead of the one of the transferor. Finally, the argument that the death tax is a cross-check for income tax purposes is only an argument for the retention of the administration of the tax in the hands of the federal authority rather than of the provincial authorities. However, the combined influence of these several arguments, although not individually convincing, is sufficient to uphold a retention of the tax in some form. It might be suggested that a combination of a capital gains tax and a death tax is a double tax on capital, but in so far as the first is only a tax on realized capital gains, the second is complementary to it. It is by way of being a once-in-a-lifetime net wealth tax. In any event, the authors would prefer to regard the tax at death not as a tax associated with profit accruing to the deceased, involving the concept of ability to pay, but more as a tax on property the state has enabled the taxpayer to own, to enjoy and to benefit from. In the end he is privileged to dispose of this property, that disposal being protected and effectuated by virtue of the laws of the state.

An associated problem is whether the federal government should be involved in such a tax. From a theoretical viewpoint, it appears that in so far as the provinces have sole authority to control and regulate succession, they have some prior right to tax in this area. More widely, however, the authors prefer the argument that the benefits to a Canadian who owns property accrue to him as much as a result of government by the federal authority as by the provincial authorities. Furthermore, in practice, seven of ten provinces look to the federal government to collect the death taxes for them, and the federal government should not have to act as a collection agent without receiving some share of the proceeds.

A return to an inheritance tax was briefly considered, that is, a tax on the recipient of a bequest at death. This, although a satisfactory tax in itself, in that it is administratively acceptable, would tend to be changed merely for the sake of change, and would not achieve a basic aim of this Study which is to extend the tax so that its impact is more equitable and less haphazard. The broad avenues of avoidance by way of inter vivos gifts and by way of trust (unless property passing on the cesser of life interests were to be taxed) would remain. Furthermore, it is understood that the taxing provinces are considering moving from a true inheritance tax to an estate tax principle, there being something apparently unsatisfactory about a tax whose burden is calculated by reference to what the recipient receives rather than what was the extent of the estate, but without considering the recipient's overall relative ability to pay. Thus, a millionaire and a pauper in the same relationship to the deceased pay the same tax. Also, succession duties would not be in accord with the present trend in testamentary practice of directing all the tax to be paid out of the residue of the estate.

Also considered as an alternative to death taxes was a net worth tax, which is a tax on the net value of the taxpayer's assets including unrealized appreciation. Such a tax may be levied by a low annual tax at a flat rate or on a graduated scale. Despite the sometimes sweeping dismissal of this tax on the grounds that it is not administratively feasible, it is used in several European countries, not merely as a tax of last resort, but, in those countries where tax morality is high, as a tax of considerable revenue consequence. However, apart from the economic argument that such a tax inhibits growth, it is unsuitable to discuss it here, in that it is not a true alternative to a death tax; we note that several European countries have both.

The authors have therefore returned to consideration of three ways by which all transfers, whether <u>inter vivos</u> or at death, may be treated either similarly or in an integrated fashion.

INCLUSION IN THE PERSONAL TAX

The authors have investigated a simple overall plan in which death and gift taxes would be superseded; gifts and bequests would be included in what they will call the "personal tax". Thus, we would not have an "income tax" to tax accretions from business, property and from an office or employment, a "capital gains tax" to tax accretions from the realization of capital assets, a "gift tax" to tax accretions by way of <u>inter vivos</u> transfers, and an "inheritance tax" to tax accretions by way of transfers at death. There would, instead, be a "personal tax" which taxes all net accretions of economic power to an individual or tax unit between two points of time. The tax is a tax on the sum of personal consumption and net capital accumulation which includes the whole of the change in the value of a man's store of property rights between two points of time. The attractive simplicity of this "personal tax" is that it is a tax on a uniform measure of the increase in the individual's command over resources in a period, regardless of the process by which the increase was brought about. It might only differ in the treatment of different accretions (i.e., by permitting an averaging provision for some types of accretion) in order to reflect the argument that, in a progressive system of taxation, unique or non-recurrent receipts which may be received infrequently (e.g.,gifts or bequests) do not confer the same spending power on the recipient as recurrent receipts of like amount within the same period of time.

Under a system which taxes the individual or family tax unit by means of a "personal tax", the following occurs at death:

(1) The deceased's estate is taxed on the basis of a deemed realization at death. The study on capital gains 1/ notes that if the tax on improvement in value of the individual's property is to be effective, it must:

(a) impinge only when that improvement in value is reflected in actual receipts, that is, the improvement must be subject to tax only when realized; except

(b) where there is a permanent loss of Canadian residence or where there is death, then there must be constructive realization.

Only by (a) can the tax be administratively effective, and only by (b) can it approach equal treatment of equals. Point (b) brings us to consideration of tax treatment at death, and in this "personal tax" plan, the tax to be imposed on the deceased's estate at death would be the same tax as in any other year, save that in the year of death the "personal tax" on net accretions of economic power between two points of time would include those accretions to the value of his property, which, though not realized, are constructively realized by reason of the notional transfer from the deceased to his estate. These accretions are given the same tax treatment as that accorded other accretions, save that, because they are unique, non-recurrent receipts, averaging back is provided.

The authors now turn to the recipient of the deceased's property, and here the "personal tax" is imposed on the recipient. When one looks to see what is the change in the value of his store of property rights in the year of receipt, one finds that, apart from his receipts such as wages or fees, and possibly realized capital gains, there is also an addition to property in the form of a bequest; this is taxable under the "personal tax". It can immediately be seen that such a tax at our present income tax rates, and with the lack of an applicable provision for averaging, would be crippling in the year of receipt of a unique, non-recurrent large bequest. It would therefore be necessary to provide that the value of the bequest be spread over, say ten years. Thus, for instance, 10% of the value of the bequest could be included into the taxable accretions for each of the following ten years.

It will be noted that one of the basic decisions to be made in the "personal tax" is to take note of the family as a tax unit. It would be necessary for intra-family gifts and bequests to receive special treatment, and also for special treatment where a member of the family leaves the family taking property with him.

There is some theoretically sound argument for including all gifts and bequests in the income of the recipient for the purposes of the income tax. The judicial view has always been that gifts and bequests are "not profits or gain at all". 2/ That is, keeping the source concept in mind, if only what is received separately from a source can be treated as income (i.e., the fruit, not the tree), then gifts and bequests are excluded on the grounds that there is nothing of which they are the income. However, from the standpoint of equity and the distribution of taxes according to ability to pay, this tax base, developed by jurisprudence, can be critized in that it excludes from taxation gains such as gifts and bequests which represent taxable capacity. These are realized accretions to wealth and increase the recipient's spending power, and one would be hard pressed to explain their exclusion from accountability in determining the recipient's annual contribution to the state were it not for the following practical considerations.

First, gifts and bequests, by their particular nature, are accretions which should be subject to a tax of some kind, but they are not of a form that readily submits to annual tax treatment. From a juridical viewpoint, they do not have the qualities of periodicity or recurrence which are normally associated with most items which make up the flow of income from a capital source, and from a practical viewpoint, the type of averaging provision needed under the current rate schedule to resolve the sudden unexpected inclusion into one year's income of an amount which may be many times the average annual income of the recipient, would have to be extremely extensive. Any averaging provision becomes administratively more difficult the longer is the period which it covers.

Secondly, the inclusion in income at the donee's applicable effective rate of property bequeathed to him by his father, such as a $100,000 family business, could have an adverse effect, despite the possible amelioration of a very lengthy payment period of the transfer tax thereon. In the perhaps frequent instances where there is no tax planning, the authors fear that this might, to some extent, result in the disappearance of some such businesses in this country. There would be substantial difficulty with non-liquid assets unless very generous averaging and terms of payment were included; such provisions themselves tend to be breeding grounds for avoidance techniques.

Thirdly, as soon as we leave the realm of realized accruals and include into an annual tax, values which are only deemed to be realized, severe liquidity problems might arise. At present our income tax has, as a general rule, only taxed realized accretions so that payment difficulties are not acute. To include in the value of accretions subject to an annual tax property, be it a painting, a house, or a business, which is not liquid, could engender payment difficulties which are awkward in a once-in-a-lifetime tax but which would be acute in an annual tax. The authors have already seen that the liquidity problem in payment of death taxes requires a solution, but practitioners and administrators alike would be concerned at the liquidity problems engendered and the averaging provisions necessitated by such an annual tax.

However, it is not intended here to discuss further the proposed development of a "personal tax". Its purpose would be to eliminate distinct tax treatments of differing accretions to economic power, and it thus would do away with "gifts" or "inheritance" taxes as such. These particular forms of accretion would be affected more frequently than most by averaging provisions, but this would merely be a specific application of a generally available treatment, and not a distinction as to the quality of the accretion itself. The effect of the "personal tax" in its application to an accretion, both in the hands of the holder at the point of constructive realization of capital gain at death, or when making a gift, and also in the hands of the recipient at the time of receipt of the gift or bequest would necessitate a detailed investigation into transfers into, within, and out from, the family taxable unit.

This review of a method whereby gifts and bequests would be integrated into an overall personal tax has necessarily been short as this is a Death Taxes Study, the terms of reference of which require the authors to consider and suggest improvements to the present system of taxing upon the change of control of property at death. They have regarded this as a specific subject with specific problems and it may well be that if a comprehensive tax plan for the personal tax structure is evolved by the Commission, it will be found possible to include gifts and bequests into the personal tax, particularly if substantive changes were made in any or all of averaging, the tax base, the tax unit, or the tax rates. Meanwhile, it is intended to devote the balance of this chapter to alternatives which accept the distinctions of gifts and bequests vis-à-vis other accretions, and which, at the same time, attempt to tax both gifts and bequests in some integrated fashion. The authors do not necessarily thereby endorse the different treatment of these particular forms of realized accretion, but they do think the three practical considerations set out above lead to a preference for it; furthermore, they do not believe that pragmatism is necessarily in itself devoid of a certain kind of equity.

Consideration is now given to two forms of tax which are based upon the following assumptions.

Gifts and bequests are forms of transfer between persons which should be similarly treated, but which should be differently treated from other accretions to wealth. This proposition is developed in the following discussion of two taxes, the "integrated transfer tax", and the "accessions tax". They recognize that gifts and bequests are such that in the content of the present tax rates, tax-paying unit and averaging provisions they cannot be subject to an annual tax on accretions. Such transfers often impose a liquidity problem because, unlike annual accretions (and indeed sporadic accretions such as capital gains), they are not necessarily realized in the form of money or its equivalent. For this reason, the problem of creating an adequate payment provision becomes extremely difficult. In addition, it can be argued that a distinction in tax treatment should be made between mere transfers (which decrease the "wealth" of the donor to the equivalent degree that the "wealth" of the recipient is increased), and forms of accretion subject to annual tax which are the result of some economic activity.

At the same time, it is emphasized that gifts and bequests should be similarly treated because they are both mere transfers of property. Dissimilar treatment leads to inequities and tax avoidance as now evidenced in gift and estate taxation.

If the personal tax concept calls for taxing such transfers in the hands of the recipient, then an accessions tax would achieve this result. If, on the other hand, an alternative concept in which transfers (gifts and bequests) are considered as items of personal consumption is preferred, the tax on such consumption to be borne by the donor, the integrated transfer tax achieves this result.

THE ACCESSIONS TAX

An accessions tax is best described by Shoup 3/ when he says;

> The accessions tax is a cumulative tax on the recipient of gifts and bequests. The tax is graduated progressively according to the total amount of gifts and bequests received by a given individual.... When a gift or bequest is received, it is added to the total of taxable gifts and bequests previously received, and a tax is computed on this total according to the current set of rates. A tax is also computed at the current set of rates on the previous cumulative total, and the difference between the two taxes is the tax currently due.

The accessions tax has certain points to commend it; it approaches the situation outlined above, where accretions in the nature of gifts and bequests are included in the personal tax. That is, the tax is placed on the recipient, and although it does not look to his other accretions in the year to establish the rate, the total of his other gifts and bequests are included in order to compute the rate. Thus some attempt is made to grade the tax according to the recipient's ability to pay. The recipient may have dissipated all his previous gifts and bequests, but this is no argument for varying the tax on the latest receipt. The general trend would always be that those who receive most pay the most. This is likely to encourage wealth distribution, as there will be a tendency to distribute wealth widely. A tax on the donor of wealth does nothing to encourage the dispersion of wealth in the same way, and, in fact, generous exemptions to close relatives probably hinder distribution because they encourage retention of wealth in close family groups. The cumulative aspect of the accessions tax also stimulates spreading; the present method of gifting large sums of money by annual gifts of $4,000 will cease, for after the initial exemption, they will be taxed at progressive rates. Thus, a gift of $100,000 received by A in one year and a similar gift received by B over 20 years are similarly taxed; and this is in accordance with an aim of this Study which is to seek a tax system which is neutral as to the channel used for the transfer, and as to when and how the transfer is effected.

The authors have looked at the systems of certain other countries in an attempt to evaluate this tax, and also to investigate the methods of implementation. In Japan, the tax was brought into force as a result of the Shoup Mission Report, but in 1953 the cumulative accessions tax was repealed, and an inheritance tax and a gift tax enacted. The only cumulative aspect of the tax remaining is in the gift tax where if A receives from B gifts in three successive years each exceeding 100,000 yen, the tax on the second and third years is calculated on a cumulative basis. It is understood that the accessions tax was abandoned in Japan because the administration in the early 1950's had difficulty with the tax; also, various fraudulent methods of transfer, involving the different exemptions depending on the age of the recipient and the progressive rate on accumulated gifts, rendered the tax unsuitable. The South African tax, which is also a tax on the recipient, was also considered but it is not believed that its donations tax and estate tax were suitably integrated for our purposes.

In Austria, Belgium, Finland, Greece, Italy, the Netherlands, Portugal, Spain, and West Germany, the death and gift tax rates are the same. It appears that this is the prime requirement for any form of integration, and one can safely say that if nothing more is done than this, something has been achieved. At the same time, if we do not have the same rate scale for both taxes, integration is impossible. In South Africa, where it appears that the rates are dissimilar, the extent of the integration would not appear to be great. The second factor is that in several countries there is a form of accumulation. In Austria, for instance, for the purpose of applying the progressive rates of both the gift and death taxes, all gifts made in the previous ten years to the beneficiary by the deceased or donor are aggregated to determine the rate applicable to the last gift, and a credit is given for the tax already paid. In Finland, the period is two years. However, it is to be noted that: (i) the gifts accumulated are only those from the same donor, not all gifts from all donors in the period; and (ii) the periods of ten or two years give an opportunity to minimize the tax by spreading the gifts over a period of longer than ten or two years. Presumably both these modifications of a full-scale accessions tax, which would accumulate all gifts in the recipient's lifetime from all donors, are for administrative purposes. The third factor is that the rates vary with the relationship of the donor to the donee. Between spouses and children in Austria, the effective rates on gifts and bequests range from 2% to 15%, while, if the donor is a stranger to the recipient, the effective rates are from 14% to 60%. This, of course, is one reason why the accumulation is limited to previous gifts made by the same donor in calculating the rate applicable to that gift. A fourth factor is that certain countries grant exemptions in relation to the recipient's dependants. The tax can be variously developed, and we show this by the following chart.

ACCESSIONS TAX

(A tax at progressive rates imposed on recipients of gifts and bequests.)

A. Tax on (a) gifts
(b) bequests
are; 1. The Same. 2. Different.

B. To establish the rate applicable to a gift or bequest in question;

3. Accumulate all previous gifts and bequests received.

4. Accumulate all gifts and bequests received in the last ten years.

5. Accumulate only those previous gifts from the donor of the gift in question to calculate the tax.

6. Accumulate all previous gifts and bequests from all donors to calculate the tax on the gift in question.

7. Differentiate the tax payable by varying the rates in accordance with the relationship of the donor and donee.

8. Differentiate the tax payable by tax credits or exemptions where there is a close relationship.

9. Differentiate the tax payable by tax credits where the recipient has dependants.

By way of comment on each point:

1. The tax rate for both gifts and bequests should be the same to achieve even the most elementary form of integration.

2. The differentiation in rates which we have now is a direct source of the inequities sought to be solved.

3. It would appear to be theoretically sound to accumulate all gifts received by a recipient in his lifetime, 4/ in that only by this method is everyone treated similarly over the complete life span. A man who receives a $500,000 bequest in year 50, pays the same tax over the period as he who receives fifty $10,000 gifts in years 1 to 50. Thus, it is the recipient's lifetime ability to pay which is considered, rather than his annual ability. However, it is to be noted that it is hardly correct to refer to the tax as reflecting variations in ability to pay, as the other accretions and wealth of the recipient are not taken into account. There is then not only a different treatment of various types of accretion, but there also remains the difficulty that the millionaire and pauper are still similarly treated if they both receive the same total amount by way of gift or bequest. He who receives and squanders $100,000 over 30 years would pay the same tax on the next dollar as does the millionaire who has received the same amount and invested it. A reference to the ability to pay of a recipient should be a reference to his ability to pay at the time of receipt of the gift or bequest, not a reference to his accumulated ability to pay as a result of gifts and bequests received, possibly many years before.

4. An alternative would be to aggregate only those gifts and bequests received for a suitable period before the gift or bequest, say, ten years.

The authors think that there must be some aggregation of gifts made in immediately preceding years to deal with the situation, prevalent now, whereby a series of small gifts at low rates are made over the years and attract substantially less tax than the same total amount bequeathed in one lump sum. This favours those who are fortunate enough to have liquid wealth, and they see no reason for this. If some degree of aggregation is necessary, a time period must be found which is suitably long, and yet not (for reasons given under 3 above) a lifetime. Any period will allow gifts to be received at intervals just further apart than the period chosen, but looking to the recipient's ability, it would appear that after 10 years there is little benefit felt from the gift that is not taxed by the income tax on income therefrom. Ideally, such gifts should be spread over the years and brought into income (see the plan outlined in the "Personal Tax" above), or the accessions tax on such gifts should be spread.

5. It was noted that certain European countries accumulate only the previous gifts to the recipient made by the same donor who made the gift or bequest in question. Thus, if A makes a gift or bequest to B, to calculate the tax to be paid by B, one only aggregates those gifts made by A to B, and one does not include the gifts made to B by X, Y and Z. The same procedure can be followed whether the ten-year rule or the lifetime rule is adopted. It is understood that the main reason for this method is because different rates apply depending on the relationship of the donor and donee, and one can hardly aggregate the gifts made by a father and a stranger, when tax on the first is paid on the basis of a very much lower rate schedule than the other. However, this is no hindrance to us, as it is not intended to suggest different rates for different relationships. However, there is an argument for including only other gifts from the same

donor, for if a father's bequest to his son is made after other gifts to the son, the father's gift, which the son had the greatest right and expectation to receive, is the highest taxed. This argument does not have much weight, as it is what the recipient receives, not where he gets it from, which should be the determining factor.

6. The authors therefore prefer the alternative of accumulating all previous gifts and bequests from all donors in order to compute the tax on the gift in question. This appears to be theoretically the more acceptable view, and it seems that the administrative problem would be no greater.

7. The authors have already indicated that they do not wish to differentiate the tax payable by varying the rates in accordance with the relationship of the donor to the donee. This cannot be done if point 6 is preferred to point 5, and they are of opinion that the differentiation can better be done by exemptions than by a series of rate tables. Also, if the purpose of such an alleviation to the system is to pass tax-free money to the dependent relatives of the donor in order to provide for basic amenities, this is better done by way of an initial exemption calculated to meet those requirements; above this amount the recipient pays at the same rate as he would on gifts or bequests from any other donor, rather than at a lower rate, which provides no tax-free money even at the lowest level. Nor would they wish to see a system where both methods are used to achieve the one objective. Note from the chart that point 6 does not lead to point 7.

8. The authors are therefore in favour of providing some system of exemptions to enable relatives to make gifts or bequests without the recipient being taxed thereon until some suitable level is exceeded. They do not think

a tax credit system would be suitable here, though they mention tax credits in connection with point 9. The following is suggested, being based on the assumption that point 4 rather than point 3 is chosen.

A recipient of a gift or bequest who is aggregating all his gifts and bequests of the last ten years may deduct from the aggregation, before applying the rate schedule, gifts and bequests to the value of $10,000 received from a person or persons to whom the recipient was related by blood, marriage or adoption and on whom the recipient was dependent by reason of age or infirmity.

The authors are not convinced that such an exemption is necessary; furthermore it is cumbersome; however, if it is felt that some exemption is needed; this is the form we suggest. In essence, it provides the recipient with $1,000 a year in gifts and bequests free of the tax if received from relations and if he was dependent on them.

9. Either in conjunction with, or apart from, the exemption system set out in point 8, they have considered whether some relief should be provided, measured by reference to the family situation of the recipient. It is noted that in Belgium and France, the transfer taxes give allowances where the recipient has dependent children. Once again, this approach is an attempt to reflect the ability to pay of the recipient, and it is thought it would be useful to incorporate something similar to that found in the income tax. There, a taxpayer is entitled to exemptions or tax credits in respect of dependants, on the assumption that his ability to pay is affected by their dependency. It is therefore suggested that a system such as the following be considered. Allow the recipient, when aggregating all

gifts and bequests in the last ten years, to deduct from the aggregation, before applying the rate schedule, $1,000 for his spouse and $500 for each dependent child.

Before turning to the "integrated transfer tax", some of the drawbacks to the "accessions tax" should be mentioned.

First, if the recipient were to be taxed on his gifts and bequests as well as on his other accretions, it would be better to integrate all accretions into one tax base. This necessitates acceptance of the debatable concept that there is no real distinction between gifts and bequests and other forms of realized accretion. Once this is accepted, to impose two different taxes on the recipient is to invite the development of avoidance techniques. It is understood that one of the main administrative difficulties encountered by Japan with the accessions tax was that various fraudulent schemes were evolved to cloud the distinction between gifts and contractual payments.

Secondly, it has been argued that the accessions tax, in that it looks to the ability to pay of the recipient, is more equitable than an estate tax. This advantage is illusory, for the reflection of ability to pay in the application of the tax is capricious for several reasons:

(a) Regard is not given to the other accretions of the recipient.
(b) The recipient, as with all inheritance as opposed to estate taxes, can still be either a millionaire or a pauper and pay the same tax.
(c) The exemptions proposed to inject some differentiation in tax by reference to the obligations or situation of the recipient are at best a rough attempt to reflect the varying abilities of different recipients.

(d) If a simple residence test were used, the expectant recipient could "emigrate" every time he expected a particularly large gift.

Thirdly, there is a possibility that the problems created by enabling tax to be deferred through the use of trusts would not be alleviated, but in fact may be worsened. It is understood that certain officials of the United States Treasury Department have voiced concern on this aspect of the accessions tax. Note that Vickrey 5/ says of the accessions tax:

> ...the tax would be based solely on the cumulative amount of such accessions. The trouble with such a proposal is that the line between clear possession and possession subject to conditions sufficient to ward off the imposition of the tax is likely to be more difficult to define and more tenuous in substance than many of the lines drawn under existing laws, and trivial differences may greatly postpone the tax, if not avoid it altogether.

THE INTEGRATED TRANSFER TAX

The authors turn now to a discussion of an integrated transfer tax, and they think it convenient to discuss the advantages of this system in the light of the inequities of our present system. The present gift and estate tax structure has several inequities with one basic underlying defect—that is, that changes in the form of transfer of property and differences in the channels through which the property is transferred result in substantial tax differences, even if the ultimate recipient is the same. If these tax differences were to implement a social objective, they would probably be acceptable. But they think the sort of giving which attracts gift tax, that is, gifts of over $1,000 and total gifts in a year by a donor of $4,000, seldom is done for altruistic reasons. Such gifting almost invariably has the primary purpose of splitting wealth to reduce the death tax impact. As no persuasive social objective can be found, the differences appear to be inequitable and capricious.

The twofold method of taxing transfers, which causes tax to vary appreciably depending upon when and how a disposition is made, has several undesirable effects. First, it would seem to be a basic aim that the tax law should strive toward such neutrality that taxpayers are moved by normal motives rather than by tax consequences when disposing of property. At present, tax consequences are a paramount consideration because of the disparity between the gift tax and the estate tax and also because of the substantial income tax advantage derived through the making of inter vivos gifts. Secondly, an equalling of rates in the two taxes would not resolve the differential in burden. For the exemptions are different, and also the amount paid as estate tax is part of the base on which such tax is computed, while the amount paid out as gift tax is not included in the base, nor is it included if the gift is brought into the estate under section 3(1)(c). Lastly, the gift tax, although introduced to prevent income splitting, has exemptions which are sufficient to frustrate this purpose.

The aim of this part of the Study is to propound an integrated transfer tax which produces an approximately equal tax whenever and however a transfer is made.

Consideration therefore has been given to an integrated transfer tax whereby a single progressive rate is applied to all transfers made during the life of, and at the death of, a transferor. Liability for tax would fall upon the transferor or his executor with, possibly, a secondary liability as surety falling upon the transferee. All transfers during life are accumulated and the tax on each successive transfer is calculated by applying the progressive rate schedule to the accumulated total of transfers and then allowing a tax credit for all tax so far paid. 6/ Integration would achieve the effect that, except for the fact that lifetime transfers would reduce the estate at death by the amount of the transfer tax paid, the total transfer tax burden would be approximately the same whether or not the transfers were made over the lifetime, or concentrated at death. Note also that it would be possible to include the tax on an inter vivos transfer, along with the transfer itself, in the property taxed at death, though it is believed that, for ease of administration, this could only be done in connection with gifts made in the last year of life.

A single-rate schedule would be established, and this in itself will safeguard the estate tax. No suggestion is made as to the transfer tax rates here, as they are not immediately concerned with revenue. Furthermore, it is first necessary to reach some decision on exemptions.

The authors have considered several alternative treatments of exemptions. It is possible for the transferor to have one large exemption which he may exhaust as he sees fit, either during lifetime or at death or both. The other extreme is to provide only an exemption at death, as the purpose of the exemption is to provide for dependants of the deceased, such provision being unnecessary in the lifetime of the deceased when he is actively wholly supporting the dependant. The third alternative is to provide two exemptions, one for lifetime gifts, and the other at death. During life the transferor can exhaust his lifetime exemption and at death he has a further exemption to which he can add any unused balance of the lifetime exemption. At present, gift tax exemptions unused at death disappear; it would appear equitable to allow unused gift tax exemptions to be included into the exemption at death. On the other hand, the transferor should not be free to accelerate the death-time exemption, as, if its purpose is to benefit dependants when they are deprived of their primary source of support, this purpose would be frustrated if the transferor could exhaust his death-time exemption during his lifetime.

The authors favour this third alternative, and suggest that a \$100,000 total exemption be provided, of which \$50,000 might be taken up during a lifetime. Inter vivos gifts over \$50,000 are accumulated to calculate the tax payable on each successive gift and at death all gifts made during lifetime are included into the estate. If the estate exceeds \$100,000, tax is payable on the excess (the \$100,000 being a "true" exemption). If the estate is less than \$100,000, but some gift tax has been paid, no rebate is provided. To some extent this will be an incentive to retain assets above \$50,000 until death, when it is most needed. Also there should be an exemption of \$1,000 per annum per recipient to avoid taxation of Christmas presents, etc.

It is necessary at this point to deal briefly with rates. The uniform rates could, they believe, be the rates which are now applied under the Estate Tax Act. It has already been mentioned in Chapter 1 that the rates are reasonable, and it is suggested there that the rates could be continued on to 60% in three further brackets. That suggestion is incorporated here.

One of the problems of administration of a cumulative tax is the difficulty of lifetime accumulations being adequately reported and recorded. It is understood that a central recording system could be maintained at the Taxation Data Centre and it is not thought that this is too difficult a task.

CONCLUSION

The authors are inclined to favour the "integrated transfer tax" as a suitable alternative to our present system, though the "personal tax" or the "accessions tax" are both systems meriting close consideration. They would emphasize, therefore, as a feature common to all three, and a feature which they are convinced must be implemented to halt the present successful avoidance techniques, that it is of primary importance that the rates applicable to gifts and bequests be the same. From this point, one can proceed to integrate these two accretions with other accretions, and include them in a "personal tax", or treat them as of a different character and not admit of such integration. In such case either an "accessions tax" or an "integrated transfer tax" can be utilized depending on whether it is desired to tax the accumulated wealth of the recipient or that of the donor.

The authors believe that the "integrated transfer tax" would conform to the requirement that equality, or neutrality, of tax burden be achieved regardless of "the methods and channels of devolution by which property may be passed from one set of holders to another, provided only that the initial and final distributions of wealth are the same. The tax burdens should not be affected by irrelevant or trifling differences in the methods by which a given ultimate distribution is achieved. At the very least such differences as do arise should be related to acceptable social goals and not be merely the haphazard result of taking the line of least resistance in the manner of assessing the tax. In short, the tax burden should be so assessed that the same burden will be imposed on the transfer of a given sum from one generation to another regardless of the number of steps in which this is accomplished". 7/

It is believed this could be achieved by the integrated transfer tax. Such a tax would tax all gifts made by a donor relatively the same especially if the burden of tax on inter vivos gifts and gifts at death were equalized as discussed above. The other major requirement to achieve neutrality would be a means of preventing deferment of tax by gifts in trust which would suspend the outright transfer of the property to another beneficiary beyond that possible by outright transfer. To do this absolutely equitably would require a more complex system. 8/ There are various other methods such as a periodic tax on funds held in trust which would provide a rougher equality. 9/

REFERENCES

1/ A published study prepared for the Royal Commission on Taxation.

2/ Rowlatt J. in Ryall v. Hoare, (1923) 2 K.B. 447 at p. 454, 8 T.C. 521 at p. 526.

3/ Report on Japanese Taxation by the Shoup Mission, Volume II, Chapter 8.

4/ The United States, for example, has a cumulative base for computing gift tax. After taking advantage of a $3,000 annual exemption and a lifetime exemption of $30,000, the gift tax rate is based on the aggregate taxable gifts made by the person in his lifetime.

5/ Agenda For Progressive Taxation, New York: Ronald Press Co., p. 250.

6/ The calculation would be very similar to the computation of United States gift tax under sections 2501-2524 of the Internal Revenue Code.

7/ Vickrey, op. cit., p. 214. See also Appendix, p. 81.

8/ For example, the "bequeathing power tax" system suggested by Vickrey, op. cit., p. 224, or a tax based on the age difference between donor and donee, p. 216.

9/ See G.S.A. Wheatcroft, Estate and Gift Taxation, London: Sweet and Maxwell, 1965.

TECHNICAL APPENDIX I

COMMENTS ON DRAFTING AND LANGUAGE PROBLEMS IN THE ESTATE TAX ACT

"PROPERTY PASSING ON DEATH"

The first difficulty is to appreciate the precise relationship between section 2(1) and the opening sentence of section 3(1). Section 2(1) is the charging section, tax being levied "upon the aggregate taxable value of all property passing on the death". "Aggregate taxable value" means aggregate net value less certain deductions. Section 3 attempts to show what is comprised in aggregate net value, and it opens by saying that aggregate net value includes "the value of all property passing on the death", plus the property listed in items 3(1)(a) to (q) as elaborated by other provisions. The issue is whether there can be property which comes within section 2 but does not come within section 3 considering the extreme scope of the enumerated items in section 3(1). This has been the subject of much legal argument in England, after whose Act the Canadian is patterned, and the House of Lords has now held for all practical purposes that it is impossible to conceive of "property passing" which is not encompassed in the enumerated paragraphs of section 3(1). 1/

USE OF THE TERM "DOMICILE"

Exception is taken to the use of the phrase "domiciled in Canada" and to the apparent inconsistency in its use. There is judicial authority casting doubt on the proposition that one can be "domiciled in Canada" as opposed to "domiciled in a province of Canada", the latter being the phrase which was used in the Dominion Succession Duty Act. Also, inconsistencies arise because other sections of the Act use tests which vary and conflict with the test of domicile. For example, Forms E.T. 60 and E.T. 61 have blank spaces for the executor to fill in the "province of domicile". In section 9(1)(a)(i)(B) an alternative test of domicile or residence is used. Further deviations from the test of domicile are found in sections 9(8)(d)(ii) and 47(3). If the suggested change to the residence test is effected, these inconsistencies should be eliminated.

DEDUCTIONS UNDER PART II

Section 35(1) prohibits a deduction in the case of Part II estates for debts or encumbrances of any kind whatsoever except those which are secured by some charge against the property, such as a mortgage. A bank loan, in no way secured by property, would not be deductible. This provision appears to be too harsh, and there is no apparent reason for its strictness. A creditor can sue and levy against property notwithstanding that he had no charge against it. It is understood that the administration of this provision has been liberal. It is thought that the law should be made to conform with practice. To make the provision too wide opens avenues for avoidance, but the section ought, however, to be at least wide enough to cover the bank loan situation.

GIFT TAX ON INTER VIVOS GIFTS

To prevent dissipation of estates just before death, gifts inter vivos made within three years of death are brought into the decedent's estate, a tax credit for the amount of the gift tax paid being allowed to the estate. In England and Ontario, the period is five years, but it is felt the three-year period should be retained as the longer the period, the greater the administrative complexity. This period does invite a certain amount of tax avoidance but so would any period. The avoidance is not serious enough to deserve amendment, and in any event, it may be said to arise more from the inadequate rate schedule of the gift tax provisions, and the lack of integration of those provisions with the Estate Tax Act. However, the provision as it stands fosters avoidance by failing to bring into the estate the gift tax paid by the donor on a gift. If A gives B $800,000, and pays gift tax of $200,000 he has effectively reduced his estate by $1 million. Yet if A dies within three years of death only $800,000 is required to be brought back into the estate and, in addition, the estate is allowed a gift tax credit. There is no satisfactory technical or policy reason for this treatment.

AMOUNT OF INTER VIVOS GIFTS TO BE BROUGHT INTO CHARGE

Inclusion of the total gift in the estate to some extent conflicts with gift tax exemptions. Under gift tax law, only gifts in excess of certain exemptions are taxable. Yet if a transfer is made up to the amount of the exemption and the transferor dies within three years, that exemption is lost. The estate tax takes back from a decedent what the gift tax exemption granted to him in his lifetime. To be consistent, the estate tax ought to require that only that portion of the gift in excess of the decedent's exemption be brought into the estate. The authors are not convinced that the policy of taxing all gifts made within three years of death requires amounts which are otherwise exempt to be brought into the estate.

CLARIFICATION OF SECTION 30

Special rules respecting valuation of gifts, aimed at tax avoidance, are provided in sections 30 and 31. The authors are in accord with the principles underlying these sections. However, section 30 is confusing as it is unclear whether the last two words "his death" in the last part of the section refer to the donor or the donee. If they refer to the donee, then it may be necessary to wait until the donee's death before a valuation can be made, which may not occur until long after the death of the donor. Grammatically, the words "his death" may refer to the donee, but logically this should not be so. The argument that the words "his death" refer to the donee but that they only come into operation if the donee dies before the donor, is difficult to support on a literal reading of the Act, and the authors suggest that a specific amendment should be made to clarify the meaning.

STOCK SPLITS

Section 31 provides that where a gift of stock is made, and the value is decreased by subsequent stock dividends, such stock dividends be brought into valuation. The section does not go far enough in that a stock split will effect the same result.

DISCLAIMERS

Under section 3(3)(b), the extended meaning of "disposition" for the purposes of gifts inter vivos includes the "extinguishment...of a debt or other right". Thus, a general disclaimer falls within its ambit. 2/ If a person disclaims his right to property within three years of death, he will be deemed to have made a gift notwithstanding that the disclaimer is not in favour of some specific person. Yet under gift tax law, a general disclaimer is not viewed as a gift. A conflict in concepts between estate and gift tax law therefore exists, which ought to be eliminated. As the suggestion in respect of gift tax exemptions shows, it is thought that as a general proposition estate tax should not be levied on property which gift tax laws have allowed to go free. Such inconsistencies allow criticism and promote avoidance schemes.

JOINT PROPERTY

Under the Dominion Succession Duty Act, joint property was taxed on the basis of contribution. Thus if A and B owned property jointly for which A had paid in full, then on A's death, the entire property was subject to tax in his estate. The present Act has altered this by making joint property taxable only to the extent of the beneficial interest arising in the survivor as a result of the death of the other joint tenant. Thus, only 50% of the value is included in A's estate. This change was welcomed administratively, but it has given rise to some difficult problems, particularly in the area of joint bank accounts between husband and wife, where arguments arise as to whether a joint tenancy was ever created. 3/ The matter can be tedious and difficult notwithstanding that the incidents of joint tenancy are generally known and accepted. Administratively, it would be easier to trace contributions to a joint fund than to enter into arguments on the existence of such a joint account. Although the authors are in sympathy with this problem, they do not think it serious enough to advocate a change. An attempt must be made to balance the interests of the administration with those of taxpayers and with consistency in the law. Taxpayers relying on the change made by the present Act may have ordered their affairs respecting joint property so as to conform to it. Some measure of hardship might be caused by a further change, and the authors are not prepared to find the administrative problem sufficiently great to offset this hardship.

RETENTION OF BENEFITS

Under section 3(1)(d), where a transferor retains some benefit in the property he transfers, the entire property falls into the transferor's estate. Thus, if a professional man transfers a house to himself and his wife in joint tenancy but retains office space, he has retained a benefit. Under section 3(1)(f) 50% of the value of the house is brought into the estate. But under section 3(1)(d) the whole value might be taxed, as the jurisprudence on the issue is unsettled. 4/ It is pointed out that the gift tax laws, through the once-in-a-lifetime gift provisions, stimulate gifts of this nature. To be consistent the relationship between these two sections of the Act should be clarified.

LIFE INSURANCE

In the field of life insurance, a new concept was introduced by the present Act. Insurance is now taxed on the basis of ownership, 5/ whereas it used to be taxed on the basis of maintenance of the policy, which usually meant payment of the premiums. In addition, under section 3(1)(b) of the Dominion Succession Duty Act, insurance could be taxed as "other interests". Ownership for the purpose of the present Act is not defined, except to say that under section 3(5)(a) it includes the right to change the beneficiary, change or pledge the policy as security, borrow on the policy, and cancel or surrender or assign the policy. The authors agree with the present method of taxing life insurance, although they recognize that it does, to some extent, discriminate in favour of this type of asset. They do not think objection should be made to this discrimination, for there seems to be no reason why the Canadian public's predisposition toward life insurance as a savings medium should be impeded. The section of the Dominion Succession Duty Act concerning annuities or other interests purchased or provided by the deceased has been included in the present Act as section 3(1)(j). A question arises as to whether the Department can choose which section it will proceed under. Possibly this choice should be available to prevent avoidance schemes which, though created to circumvent section 3(1)(m), might yet be brought within section 3(1)(j). The authorities at present accept the view that since section 3(1)(m) was intended to be a specific method of dealing with insurance, then all other methods are necessarily excluded, on the principle that the specific overrides the general. However, under the Dominion Succession Duty Act, a specific method of taxing insurance was also enacted but it was nevertheless believed, and the Act was interpreted, as if insurance was also taxable under the "annuity or other interest" provision. 6/ Detailed discussion is unnecessary here, but note that other forms of property, such as joint tenancies, can be taxed under more than one clause of section 3(1); (for instance, clauses (a) and (f)); the authors think it should be made clear that life insurance, like any other property, is subject to taxation if it comes within any part of section 3(1); there is sufficient uncertainty among tax planners to require amendment. 7/

CORPORATION IN BUSINESS LESS THAN FIVE YEARS

The period required to satisfy the computation formula in section 3(1)(m)(ii)(A) is the last complete fiscal period and each of the four immediately preceding ones. If a corporation has only been in business for three years, it cannot satisfy this requirement. The precise effect of this is not clear, possibly rendering all of the policy proceeds taxable, or none of them taxable. The authors understand this problem was not contemplated, and the Act provides no solution. The practice is to allow whatever period within the five years that the corporation has in fact been in business.

COMPASSIONATE PAYMENTS

Section 3(1)(1) is legislation which offends against a general policy that tax laws should be neutral with respect to business decisions. Voluntary payments by an employer after the death of an employee to a widow, for instance, in recognition of the employee's services, are taxed. The courts have interpreted this provision broadly, and have rendered taxable even patently compassionate payments. 8/ The provision could be redrafted to exempt gifts to the family of a deceased employee by an employer, if made not out of recognition of service but out of recognition of hardship to the family. Such a provision invites avoidance, but a vigilant administration should be able to regulate this proposal effectively.

BUY-SELL AGREEMENTS

If A agrees to sell B property worth $100,000 for $10,000, the sale to take effect after A's death, section 3(1)(i) will cause to be included into A's estate the difference, treating A as if he has made a gift of $90,000. Although this provision is necessary, it goes too far as it is not limited solely to transactions not at arm's length. Buy-sell arrangements between partners dealing in perfect good faith, who for various reasons decide to allow each other to buy the interest of the first to die at an agreed figure, will be caught by this section, and the Department will be able to put a different value on the interest passing, thus interfering with rights of property. Section 3(1)(i) applies to contracts made during a deceased's lifetime to transfer property on or after his death. The excess of the value of property transferred over the consideration received prior to death is added to property passing on death. Unfortunately, this section can apply to bona fide business transactions such as buy-sell agreements between business or professional partners or shareholders in closely held companies. It is common in such agreements to set an arbitrary or formula price for the interest in the business which, though it may represent the best practical bargain the parties can strike, nevertheless discounts intangibles heavily. Section 3(1)(i) makes no allowance for this. Indeed under section 4(3) all transactions within section 3(1)(i) are deemed not to have been bona fide and thus the relatively more favourable treatment under section 4(1) is excluded. It is believed that this is too harsh and unrealistic. Not all transactions coming literally within section 3(1)(i) are aimed at tax avoidance. It is recognized that some similar section is needed but it could be better suited to the variety of transactions to which it may apply.

Perhaps the simplest remedy would be to repeal section 4(3). Any bona fide transactions would then be taxed under section 4(1) and only if the value transferred at the time of the acquisition exceeds the consideration would any amount be added to property passing on the death of the deceased. This would not apply to buy-sell agreements, agreements to purchase or options entered into prior to death but not completed until afterwards so long as the valuations were reasonable and made as of the date of acquisition.

DEFINITION OF "GENERAL POWER"

The Estate Tax Law respecting powers of appointment is reasonable 9/ and complete. However, by virtue of sections 3(1)(a) and 3(2)(d) and the definition of "general power" in section 58(1)(i), property may be brought into the decedent's estate which he would never personally enjoy. When A leaves property in trust, with income to B for life, and the remainder as C shall by will appoint, then when C dies, notwithstanding that he had not exercised the power and that he could get nothing himself, his estate is taxable on the value of the remainder interest. The authors do not believe the Act should tax C who is merely a conduit through which property will be passed although there is an opportunity for deferment here. No economic advantage accrues to him personally by virtue of the power and as a general proposition they think that only in circumstances where some possibility of personal economic gain enures to the benefit of the decedent should his estate be taxable. The authors do not agree with the argument that nothing should be brought into an estate under power of appointment, if the power has not been exercised. The Act should be concerned with the economic total of a man's estate, and if he could personally enjoy property merely through the exercise of a power, then he ought not to escape taxation merely by failing to exercise that power. If a man has $100,000 stored away and dies without spending or investing it, it could not be argued that the $100,000 ought not to be taxed.

SOLICITORS' ADMINISTRATION FEES

The authors have considered several obligations of the estate which might be included in the deductions permissible under section 5. First, solicitors' administration fees are specifically excluded by section 5(1)(b).

When the Estate Tax Bill was in Committee stage, this point aroused controversy, and since then several legal groups have questioned—the authors think rightly—this prohibition. There could be found no good reason for not permitting as a deduction those solicitors' fees which are a necessary part of the probating and administering of every estate which is of such a size as to attract estate tax. The objection that such fees are not readily ascertainable can be overcome by providing a scale of permissible fees based on the size of the estate, which could be included in the Regulations, though they do not specifically suggest this.

DEBTS AND ENCUMBRANCES

The combined effect of sections 5(1)(a) and 6(a) is such that while no debt or encumbrance which the estate is not legally obligated to pay can be deducted, not all debts or encumbrances which the estate is legally obligated to pay are necessarily deductible. This is so, because of the double test that the debt must be a legal obligation of the estate, and also be incurred bona fide and for full consideration. Some legal obligations do not appear to be for full consideration. For instance, a pledge made by the deceased in his lifetime may be enforceable against the estate, and yet not necessarily supported by "full consideration". A covenant under seal is a second example. Also, it would appear that if a debt is supported by partial consideration only, it is completely without the ambit of section 5(1)(a), despite the fact that it is, to the extent of the consideration, a legal obligation. Lastly, it would appear that payments under separation agreements may have to be court-sanctioned to be for "full consideration". 10/ The authors think that the double test of legal obligation and full consideration is too strict, and that to the extent that a debt or encumbrance is a legally enforceable obligation, it should be deductible. Such an amendment would also cover the anomalous situation where a husband is legally liable for the debts of his wife incurred by her in respect of necessaries, but which were not for the deceased's "own use or benefit".

POWERS OF ENCROACHMENT

It was urged before the Commissioners that the Act should contain a provision similar to that which exists in Ontario, that where there is a power in a life tenant to encroach on the capital of a fund where the deceased has willed the residual gift of the fund to a charitable institution, the estate should be kept open until the life interest terminates, and taxed in accordance with what was actually taken by the life tenant by way of encroachment, rather than the present method of treating the power of encroachment as an absolute gift for tax purposes. The beneficial effect of this to testator, life tenant, (often the testator's wife), and charities, who presently stand to receive few such gifts, is obvious. However, one hesitates to suggest such an administrative inconvenience for the sake of extending an already beneficial provision. The tax on the whole estate would be dependent on the extent of the encroachment, and even with suitable provision for security, the estate would have to be kept open possibly for many years. 11/ Not only does the change sought appear to go against the principle reflected in section 3(1)(a), but also, if a married couple wishes to provide for each other with a residuary gift to a charity, there is nothing to prevent the survivor of the two willing the residue to that charity with consequent tax relief. If the survivor (wife) is interested in benefiting the charity, there is nothing to prevent her doing so, and if she is not so interested, she will encroach to the full extent anyway. The authors are not convinced that the burden entailed in keeping estates open for this isolated purpose is offset by any benefit which would be conferred.

CALCULATION OF RESIDUAL GIFT TO CHARITY

Testators sometimes donate the residue of their estate to a charity, providing that the death taxes be paid out of that residue. To avoid the situation where the amount of the residuary gift to charity and the tax on the taxable estate are approximately equal, so that the estate is reduced by that amount, but nearly all of it goes to pay tax instead of to the charity, the charitable exemption permitted is only that amount which actually goes to the charity after payment of death taxes. This requires a series of calculations down to the point where the difference is insignificant, a calculation which the Department has not been able to leave to executors.

However, it appears from a recent case 12/ that only two calculations need be made, the first to compute the tentative estate tax payable without reducing the exempt gift by estate tax, and the second to recompute the tax after reducing the exempt gift by the estate tax so found. Without intending to pass upon the correctness of this decision in the light of the present law, the authors think it is a sensible way of dealing with the problem, and suggest that this be the method adopted by the Department.

CHARITABLE GIFTS AND TRUSTS

It was suggested that recipients of exempt charitable gifts should not necessarily be "in Canada". However, there is no geographical restriction on the objects of the charity, and it would appear to be necessary to retain some supervision over charitable organizations. It is, however, suggested that it should be clarified that a trust for charitable purposes which is not necessarily "a charitable organization", be recognized as a beneficiary of an exempt charitable gift. 13/

DEFINITION OF "SUCCESSOR"

It would appear that a surviving spouse or child who benefits, not under the will, but by virtue of a court order under a provincial statute entitling them to an appropriate part of the estate, is not a "successor" entitled to quick succession relief. As the beneficial effect of these provincial statutes could be rendered nugatory because of the non-applicability of the quick succession rule, it is suggested that section 58(1)(r) be amended to include such a person as a successor.

QUICK SUCCESSION RULES

If property is brought into an estate by virtue of subparagraphs (b), (c), or (d) of section 3(1), and the donee dies before the donor, full estate tax would be payable on each death in respect of that property, because the quick succession rules apply only if the death of the successor occurs after the death of the bequeather. The severest effects would be felt when the deaths occur within six months of each other, and this situation also appears to be the easiest to deal with administratively, as the valuation and payment on the first (donee's) estate will either not, or only just, be completed. It is suggested that, similarly to the United States system, quick succession relief be available in such cases. Tax payable on the first (donee's) estate can be re-assessed and any overpayment refunded similarly to the gift tax refund provisions. This suggested change can be implemented independently of the main suggestion on the quick succession rules.

FOREIGN TAX CREDIT

The inclusion of foreign real property in the taxable estate of a Canadian-domiciled decedent represents a radical departure from an accepted pattern, as most death duties legislation has been framed to exclude taxation of foreign real estate, to avoid double taxation, as the country of situs will usually tax it. Where international tax conventions are in operation, the inclusion of foreign real property will not cause serious double taxation problems. Outside these conventions, the same result will be achieved if the country which imposes tax on foreign property unilaterally allows a credit for taxes paid in that foreign country in respect of that property. This is what the Estate Tax Act does. Although the inclusion of foreign real estate in Canadian-domiciled estates has been criticized, it is not found to be contrary to any basic principle, and it is acceptable, provided the tax-credit system which must accompany it is complete. The system provided by section 9(3) is only partially acceptable, as (a) it is dependent on the situs code of the Act, which was discussed when situs was dealt with, and (b) it does not grant a credit for all death taxes paid elsewhere, but only for those levied by a "country", not a legal subdivision, such as a province or a state. "Country" has no meaning in international law and is a vague and unsatisfactory word.

FOREIGN TAX CREDIT FOR TAXES ACTUALLY PAID

The construction to be placed on section 9(3) by virtue of section

9(7) is such that only credit for foreign death taxes payable can be claimed, despite the word "paid" in section 9(3). This is as unsatisfactory a situation as the one found in section 9(1), because it is understood that it is necessary for Canadian authorities to go behind any proof of foreign taxes paid and to delve into the foreign law and the calculation of the foreign authorities to ascertain whether what was paid is what was payable. This is undesirable and an unnecessarily suspicious approach. Noting that our convention with the United States establishes a credit system on the basis of "net" taxes paid, an amendment to section 9(3) to this effect is suggested.

PRIORITIES

Departmental practice is not in accord with section 9(6)(a) (which could be more aptly marginally headed, "priorities"). The departmental interpretation that the order of priority only becomes important when more than one credit applies to tax on the same property may be beneficial, and therefore go unchallenged, but it is not what section 9(6)(a) says. In a provision designed to alleviate double taxation, the beneficial view is preferable.

VALUATION OF LISTED SECURITIES

Section 27(1) provides a practical test to value listed and active securities; whether the holding is large or small, the quoted price is decisive (save in cases where the deceased had "control"). Fair market value of shares is in case law a carefully developed concept, and quotations are only a factor in the final estimate—only one of many elements to consider, particularly where the holding is large. A stock market quotation will usually be the starting point of an appraisal, but it should not be irrebuttably conclusive. 14/ The authors believe the general principle of fair market value in this situation should be left untrammelled, for often in cases of blockage, quoted price is not equal to actual value, and the secondary market price may be more accurate.

INCOME TAX LIABILITY

Section 26 is aimed at preventing a deduction of potential income tax which is not an allowable liability of an estate under section 5(2). A strict grammatical construction of the section covers existing tax liabilities, and this should be rectified. In so far as annuities and similar income rights are concerned, the concern shown over section 26 in 1958 during the passage of the Bill was largely resolved by section 11(1)(v) of the Income Tax Act, which, passed in 1960, was made retroactive to 1959. Thus, estate tax applicable to such rights is allowed as a deduction against income tax payable thereon.

However, section 26 still gives cause for concern where a company has to value shares on a net assets basis and the source of funds for taxes is the company's accumulated surplus. A withdrawal from that fund is made to pay the estate tax assessed on the value of the shares, the valuation of which has, perforce, disregarded the tax payable on the distribution of the fund built up for that purpose. This appears to be done in disregard of the Ives Commission 15/ suggestion that the Department, in valuing shares of a closely held or family corporation, should give weight to the measure of contingent liability that exists in connection with undistributed income on hand. It is illogical to value shares on the assumption that a purchaser, on a winding-up, would pay 100% for assets which contain some considerable percentage of tax liability. The problem is acute where there is a closely held company with an undistributed earned surplus which, because of shortage of funds, has been unable to make the election under section 105 of the Income Tax Act. The discriminatory nature of the section is aggravated because, if shares have a stock market value, or the shares can be valued by reference to earnings and dividends factors and by comparison with value of shares of similar corporations, such valuation will as a matter of course have imbedded in it a reflection of the potential income tax impact. But if the company is forced into a net assets valuation, section 26 prevents consideration of the built-in potential tax liability. This offends against the principle that tax should be levied on the value that could be realized from the property of the deceased, and the authors suggest the repeal of section 26. 16/

RETURNS

In considering the sections of the Act dealing with returns, the authors have the following short comments to make.

1. The rights of the Minister under section 11(2), as supported by the cumulative penalty provisions of sections 20(1) and 51(1), are such that they think some responsibility should be on him to show reasonable grounds for assuming a person has information relevant to the estate before requiring any information thereunder.

2. The Minister must assess with all due despatch (section 12(1)) but he appears to be under no similar obligation to send out a notice of assessment with the same despatch (section 12(2)). Furthermore, certain

decisions 17/ have rendered the requirement that the Minister act "with all due despatch" ineffective. They see no reason why the Minister should not have imposed on him a time limit similar to that imposed on executors, that is, six months from the receipt of the return, in which to send an assessment notice, after which the estate is relieved of tax, which would become a statute-barred debt. Executors have an obligation to beneficiaries to carry out the terms of the will within the executor's year, and there is no reason why this obligation should be interfered with by a taxing statute.

3. The last 22 words of section 12(3) extend the principle that notice to one executor is notice to all so that it is also notice to successors who may have received an inter vivos gift included in the estate by section 3(1)(c), and who are personally liable for tax thereon under section 14(1)(b). Without receiving an assessment notice, such a successor may be liable to tax under section 14(1)(b), interest under section 19, penalties under section 20, and fines under section 51, without even knowing that his donor had died. They think a separate notice of assessment should be required to be sent to successors liable to pay tax by virtue of section 14(1)(b).

4. It would be of assistance to executors if a "nil" assessment or notice of discharge were to be available where no tax is payable. There is no such requirement, section 12(5) being permissive in this respect (as opposed to the imperative requirement in section 12(2)). As the four-year limitation period on re-assessment runs from the date of notice, it is essential that a notice be sent, as otherwise the estate will never be free of the threat of re-assessment. It is thought "nil" assessments should be sent within six months of the receipt of the return.

5. The four-year re-assessment limitation in section 12(5) is largely illusory, because re-assessment can be made even in cases of innocent misrepresentation. 18/ This, combined with no requirement for a nil assessment, is unsatisfactory, and section 12(5) re-assessments should be restricted to cases of fraud or knowing non-disclosure.

6. A combination of section 11(1)(b) and section 20(1) makes it possible for a successor, ignorant of the death of the donor of an inter vivos gift made less than three years before death, to be liable for $1,000 in penalties. They think that such a penalty should only be leviable when there was a wilful failure to file a return. The appeal provision in section 22(1)(b) is of little assistance, as appeals can only be in respect of the amount of a penalty, not liability for it. Whether a failure to file a return was deliberate should also be subject to judicial review.

7. Although the above suggestion is probably sufficient to rectify section 20(1) in that it is in essence an administrative enforcement provision, they believe section 20 generally controvenes principles enunciated in the Canadian Bill of Rights. 19/ In particular, section 20(3), in that it goes beyond being a mere administrative measure of enforcement, is contrary to section 1(a) and section 2(e) of the Canadian Bill of Rights. 20/ An offence under section 20(3) should not be left to the Minister—one of the parties to the matter—to rule on, and it should be provided that a person who evades or attempts to evade tax should be guilty of an offence and liable to the penalties provided only on summary conviction.

8. The authors doubt if it was ever intended that a court decision in favour of one estate should enable a refund to be claimed by some other estate. The absence in section 21 of a distinction between mistakes of law

and fact makes this possible; they think refunds should be restricted to cases of proven mistakes of fact.

PAYMENT OF TAX IN SPECIAL CASES

The second group of administrative suggestions relates to payment of tax in special cases.

1. Sections 13 and 14 are complementary as to property within the executor's control, in that the executor is primarily liable, and the successor liable only as surety, for tax thereon. But the same situation does not obtain in reverse. The successor is solely liable for tax on property not within the executor's control. The situation can be complicated where tax on section 14(1)(b) property is explicitly directed by the terms of the will to be paid by the executor. 21/ If the successor has left the jurisdiction or gone bankrupt, can the Department rely on the terms of the will and turn to the executor? If the Department did this, could the executor, in defiance of the terms of the will, argue that there is no statutory obligation on him to pay tax on section 14(1)(b) property? The authors do not think executors should be saddled with an obligation to pay tax on property which does not pass through their hands where that tax exceeds the value of property which does pass through their hands, but they think that where the will provides that the executor shall pay the tax on section 14(1)(b) property the obligation of successor and executor should be joint and several, the will resolving who will bear the eventual burden. This would be in support of, rather than an interference with, exclusive provincial jurisdiction over wills—in fact the present method is more likely than not to interfere.

2. This Study has dealt elsewhere with treatment of annuities and similar income rights; however, as an independent suggestion it appears that section 15(1)(a) is more limited in scope than it need be, or than the comparable section was under the Dominion Succession Duty Act. It has again been ascertained that departmental practice is more beneficial than the words of the Act probably permit, in that where other property comes within the control of the executor, the successor is not prevented from paying tax in six annual instalments if all other requirements are fulfilled. They think that the section should be amended to conform with departmental practice.

3. Interests in expectancy are taxed on their fair market value at the date of death, and although in certain cases (annuities and similar income rights) the tax may be paid in six annual instalments, this does not resolve the problem that by the time the interest in expectancy falls into possession, it may have an entirely different value from the value at death, so that what the successor receives may be incommensurate with the tax he pays. They are aware of the administrative inconvenience of keeping an estate open, and the suggestion now made avoids having to do more than retain a record of the value of the estate at death. They think that the interest in expectancy should be valued at death for the purpose of inclusion in the estate so that tax payable on the balance of the estate can be assessed. At the falling into possession of the interest in expectancy, it must be revalued, and added to the original value of the balance of the estate so that tax payable on the interest in expectancy can be assessed. In connection with interest in expectancy, they also think that no interest should be payable between the death and the falling into possession.

COLLECTION, ENFORCEMENT AND PENALTIES

The next group of short comments is concerned with collection, enforcement and penalties.

1. Section 41, which provides for judgment by way of registration of a certificate, is taken from section 119 of the Income Tax Act. Apart from the fact that these forms of judgment offend against sections 1(a) and 2(e) of the Canadian Bill of Rights, such a provision is offensive in the Estate Tax Act where judgment may be entered against the executor and execution proceedings taken against his personal property. Such stringent provisions may on occasion be necessary, but they should not be put into effect without due process of law; section 41(1)(a) is the force behind section 17(2), and one party to a matter should only have power to enter and enforce judgment against the other party after some judicial proceeding, however summary, and not merely on the strength of his own opinion. 22/

The same criticism extends even more forcefully to section 42 where the Minister, on his own suspicion that a person liable to tax is about to leave the country or that property is to be removed from the country, need do no more than demand payment by registered mail, after which, upon non-payment, he can seize the personal goods and chattels of that person. This offends against section 1(a) of the Canadian Bill of Rights in that it is a deprivation of property otherwise than by due process of law; for "due process of law" implies customary legal procedure, and what makes section 42 particularly offensive is that there is a customary legal procedure specifically developed for such situations—the Writ of Immediate Extent. This seems to be rejected by the Department as too complicated, or time consuming. However, it appears that the Crown may, on the simplest of affidavits, issue an immediate extent and obtain the fiat of an Exchequer Court judge without even the formality of a motion. This ensures that an impartial mind is brought to bear on the matter, and justice is seen to be done. Also, the court order is reviewable, while the Minister's decision is not. They suspect that, in this and other similar matters in the income tax, the Department does not like having to persuade a judge that the Crown has a proper case; but only when there is clearly a proper case should such extreme measures be taken.

The authors see no reason for the power of sale in section 42(3), where it appears that even the Minister cannot hold off sale for more than 30 days. Such procedures take on a particularly aggressive character in the context of the Estate Tax Act where it is not the property subject to tax which is seized and sold, but the personal property of the defaulting executor or successor.

In the same vein, section 45 must also be criticized, which *ex facie* appears to violate section 1(a) of the Canadian Bill of Rights. Sections 42 and 45 appear deliberately to eschew those prerogative writs traditionally available to the Crown. To take away the decision to enter, search and seize from the independent judiciary and vest it in the hands of the executive is to flaunt a first principle, which is that no one should be a judge in his own cause. It places the prerogative above, instead of subservient, to the law. The search warrant is still an available remedy which would ensure due process of law. Futhermore, section 45 is unnecessarily broad in scope in that, whereas a search warrant is reviewable, except possibly to question whether the Order is for a purpose relating to the administration or enforcement of the Act, the order of the Minister is not. 23/ The Canadian Bar Association has said of this section;

> (a)...it gives powers to the Minister far beyond those necessary for protection of the Crown and makes no provision for judicial review. (b) It should be noted that there is no limitation placed upon the articles that may be seized and taken. Notwithstanding the fact that the books and records so taken have no bearing on the matter under investigation, there are no means available to the owner thereof to challenge the seizure and recover the articles....(c) The power of the police to enter and search premises under a search warrant issued by a Justice of the Peace is subject to review under Crown Office Writs, but no such protection is available here. 24/

2. The authors are concerned at the capriciously arbitrary double impact of sections 20 and 51(1)—arbitrary because it depends merely on which remedy the Minister chooses to use first as to whether both penalties may be inflicted (see section 51(3)). 25/ The piling up of punishments does not end here, for section 52 provides, in addition to any other penalty, further fines and imprisonment on summary conviction, or, under section 52(2), imprisonment up to five years. Thus, an executor who fails to file a return on demand and who is therefore thought by the Minister to be wilfully evading payment can be fined up to $1,000 (section 20(1) plus up to 50% of the tax sought to be evaded (section 20(3)). The Minister can then charge him with an offence, for which he is liable for up to $10,000 under section 51(1) and a further $10,000 or two-year imprisonment under section 52(1), or, alternatively, up to five-year imprisonment under section 52(2). However necessary these sanctions may be, the method whereby they duplicate is to be deplored. One penalty section should be provided, and in so far as already indicated that all such penalties should be on summary conviction, a way of resolving the

confusion would be to repeal section 20 and amalgamate and expand sections 51 and 52. 26/

3. Finally note, in connection with section 53 an absence of any protection of solicitor-client communications. In so far as this appears to be a deliberate omission of any section approximating section 126A(2) of the Income Tax Act, it is to be deplored.

CONSENTS

The final group of short comments on administrative provisions in the Act is concerned with consents.

1. It would appear that, despite amendments to section 47 in 1960, the section is still more restrictive as to supplementary insurance policies than was the analogous section in the Dominion Succession Duty Act. The proceeds on a life insurance policy on a husband's life which are being paid out in instalments to his widow are not covered by section 47(2), and on the death of the widow no payment can be made without consent, as the policy was not effected on the life of the widow. They think this restriction could be removed without danger.

2. A literal reading of section 48(1) prevents even a solicitor from opening his office safe if it contains a document of his deceased client. The section is unnecessarily broad.

REFERENCES

1/ Public Trustee v. Inland Revenue Commissioners, [1960] A.C. 398, [1960] 1 All E.R. 1.

2/ Re Stratton's Deed of Disclaimer; Stratton v. I.R.C., [1958] c. 42, [1957] 2 All E.R. 594. Keir Estate v. M.N.R. 65 DTC 679; (1965) 39 T.A.B.C. 303.

3/ See Conway Estate v. M.N.R., 65 DTC 5169; [1965] C.T.C. 283.

4/ See Re Hommel Estate,[1953] O.R. 64, [1953] 1 D.L.R. 536; affirmed, [1953] O.R. 739, [1953] 4 D.L.R. 387; Re Taylor; Re Hume, [1958] O.R. 335, 13 D.L.R. (2d) 470. But see the interpretation of the words used in section 3(1)(d) expounded by Viscount Simond in Chick v. Commissioner of Stamp Duties of New South Wales, [1958] A.C. 435, [1958] 2 All E.R. 623. Also see Corbeil-Gauthier Estate v. M.N.R. 65 DTC 632; (1965) 39 T.A.B.C. 205.

5/ See Colautti Estate v. M.N.R., 64 DTC 110; (1964) 34 T.A.B.C. 330; Carmichael Estate v. M.N.R., 65 DTC 554; (1965) 39 T.A.B.C. 83.

6/ Also see Re MacPhayden, [1944] 1 D.L.R. 542, where proceeds of an accident insurance policy were held to be taxable under either paragraphs (e) or (g) of section 8(2) of the Ontario Succession Duty Act, a decision upheld by the Ontario Court of Appeal at [1944] 2 D.L.R. 143.

7/ Note that in Worsley Estate v. M.N.R., 66 DTC 63; (1966) 40 T.A.B.C. 121 the Department relied unsuccessfully on section 3(1)(k) alone in respect of accident insurance.

8/ See Robinson v. M.N.R., 61 DTC 336, 26 TAX A.B.C., (1961), 379. In this only reported case on the section a disposition "in recognition of services" was taxable even though made on compassionate and gratuitous grounds. This interpretation goes beyond the mischief the section was intended to correct. Now, however, see Crispo Estate v. M.N.R., 65 DTC 5272; [1966] C.T.C. 457.

9/ Especially as interpreted by the courts; see Montreal Trust Co. (Hickson Estate) v. M.N.R., [1964] S.C.R. 647; 64 DTC 5230; [1964] C.T.C. 367; M.N.R. v. Canada Trust Co. (Maine Estate) 64 DTC 5128; [1964] C.T.C. 179; and Bowie Estate v. M.N.R., 64 DTC 297; (1964) 35 T.A.B.C. 213.

10/ See Royal Trust Co. v. M.N.R., 59 DTC 1235, [1959] C.T.C. 203.

11/ Even the provision of a bond to cover 100% encroachment will not prevent this, for if the wife encroaches to, say 60%, this must be included in the estate, and the tax cannot be assessed until the percentage is known.

12/ Bickle Estate v. M.N.R., 64 DTC 5134, [1964] C.T.C. 208.

13/ See Towle Estate v. M.N.R., 65 DTC 5042 [1965] C.T.C. 74.

14/ Note that in the Quebec Succession Duties Act, R.S.Q. 1941, c. 80, s. 17, the test is rebuttable.

15/ Report of the Ives Royal Commission on Taxation of Annuities and Family Corporations, 1945, p. 68.

16/ This situation is aggravated by the decision in Barber Estate v. M.N.R., 66 DTC 315; (1966) 41 T.A.B.C. 27.

17/ E.g., Jolicoeur v. M.N.R., 60 DTC 1254, [1960] C.T.C. 346.

18/ See M.N.R. v. Taylor, 61 DTC 1139, [1961] C.T.C. 211.

19/ S.C. 1960, c. 44.

20/ " The right of the individual to... enjoyment of property, and the right not to be deprived thereof except by due process of law"; ...the right to a fair hearing in accordance with the principles of fundamental justice for the determination of his rights and obligations".

21/ See Re Reading, [1940] O.W.N. 9, [1940], D.L.R. 387, where the will was explicit enough, and Re Mayerhoff's Application, 43 W.W. R. (1963), 345, 40 D.L.R. (2d) 69, where it was not.

22/ The arbitrary powers of the Department against an executor have been limited by the decision in In Re Smith 66 DTC 5006.

23/ See: In the Matter of the Income Tax Act and W.H. Biggs, 55 DTC 1061, [1955] C.T.C. 74; Canadian Bank of Commerce v. A.G. of Canada, [1962] S.C.R. 729.

24/ Report on the Estate Tax Act, 1959 Canadian Bar Association Papers.

25/ See M.N.R. v. Durocher, 51 DTC 497, for a criticism of such duplication.

26/ Although the new section 20(5), added by S.C. 1964 c. 8 prevents duplication of penalties in so far as the new section 20(4) is concerned (also added by S.C. 1964 c. 8) our other suggestions about having a simplified unified penalty provision subject to court conviction apply equally to these new sections.

TECHNICAL APPENDIX II

A SUMMARY OF SUGGESTED AREAS OF CHANGE IF PRESENT ACT IS RETAINED

1. That section 2 and the opening words of section 3 be redrafted to clarify that "property passing on death" means the property enumerated in the paragraphs of section 3(1).

2. That inconsistencies in the use of the word "domicile" be eliminated by proper amendments to refer to domicile in a province or territory of Canada.

3. That section 35(1) be extended in scope to conform with present departmental practice.

4. That the Act be amended to bring into charge the amount of gift tax paid by the donor on gifts *inter vivos* made within three years of death.

5. That gifts *inter vivos* made within three years of death be brought into charge only to the extent that they are subject to gift tax.

6. That section 30 be amended to clarify that the words "his death" in the last line refer to the donor.

7. That section 31 be amended to cover a stock split.

8. That section 3(3)(b) be amended to clarify that general disclaimers are not included.

9. That the relationship between sections 3(1)(d) and 3(1)(f) be clarified, and that only the value of the reserved interest be taxed under section 3(1)(d).

10. That it be clarified that insurance is taxable under sections other than 3(1)(m).

11. That section 3(1)(m)(ii)(A) be amended to conform with practice.

12. That section 3(1)(1) be amended so as not to tax compassionate payments by an employer to the family of a deceased employee.

13. That section 4(3) be repealed so that section 4(1) will apply to bona fide sales notwithstanding section 3(1)(i).

14. That section 58(1)(i) be amended to clarify that where the deceased could not exercise a power in favour of himself, such will not be a general power within the meaning of the section.

15. That solicitors' fees relating to the administration of an estate be deductible in computing aggregate net value.

16. That section 5(1)(a) be amended to provide that debts or encumbrances, to the extent that they are legally enforceable obligations of the estate, be deductible.

17. That the amount of a residual gift to charity charged with estate tax be subject only to two successive calculations to determine the amount of the charitable residue.

18. That gifts to trusts for charitable purposes be exempt.

19. That the definition of successor be extended to include a surviving spouse or child who benefits from an estate by virtue of a court order under a provincial statute.

20. That where property is deemed to be included in the donor's estate, and the donee of the property dies within six months of the donor, that property be valued at 50% in the donee's estate.

21. That section 9(3) be amended to include any foreign estate taxes or death duties paid.

22. That the credit under section 9(3) be in respect of foreign taxes actually paid.

23. That section 9(6)(a) be amended to reflect present departmental practice.

24. That section 27(1) be repealed.

25. That section 26 be repealed.

26. That the Minister be required to give grounds when requesting information under section 11(2); that the Minister be required to send assessment notices or nil assessments within six months of receipt of returns, and to notify separately successors to section 14(1)(b) property; that section 12(5) re-assessments be restricted to cases of fraud or knowing non-disclosure; that penalties under section 20(1) only be leviable when failure to file a return was wilful; that penalties under section 20(3) be dependent upon summary conviction; that refunds be restricted to cases of proven mistakes of fact.

27. That the executor and the successor be jointly and severally liable for tax on section 14(1)(b) property; that application of the instalment payment option in section 15(1)(a) be not dependent on the absence

of property passing through the hands of the executor; that an interest in expectancy be valued at death to establish tax payable on the balance of the estate, and again at the falling into possession to establish tax payable on the interest in expectancy, and that there be no interest running between these two events.

28. That sections 41, 42 and 45 be amended so that collection and enforcement procedures shall be carried out in accord with due process of law; that the penalty provisions be simplified, unified and all made subject to conviction in a court of law; that solicitor-client communications be protected.

29. That the requirement that insurance policies be effective on the life of the deceased be deleted from section 47(2) and that section 48(1) be less broad.