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By M. C. CULLITY*

It seems unlikely that the federal government lost many supporters when it decided to abolish its integrated system of estate and gift taxation.¹ Such taxes have their advocates² but most taxpayers probably regard death duties as among the most obnoxious methods ever devised for the purpose of filling the coffers of the State. They are exceedingly visible, they are levied at a time when emotions may be highly charged and they can involve the expropriation of large amounts of capital. Rarely, if ever, can they be justified in terms of the revenue they raise and, to some, their advocates seem motivated by "envy nourished by political demagoguery, and carried to the point of vindictiveness."³ The disastrous effect on family farms and family businesses is usually an article of faith rather than a conclusion drawn from evidence but it is, nonetheless, one which is firmly held in many jurisdictions.

Against such reactions and convictions, the reasoned arguments of the supporters of death taxes are likely to have little effect. "Most of us judge tax measures — in general quite correctly — by their results not by their underlying conformity to principle. If we do not like the result, we are unlikely to accept the rationale."⁴ It is not altogether surprising that the arguments for death taxes or other taxes on capital transfers are rarely ventilated at the political level in Canada. When the federal government entered the succession duties field in 1941 the Minister of Finance went to some trouble to deny that anything but the exigencies of wartime and a consequent "compelling need for revenue" were responsible for the decision. At the same time, and with some disregard for consistency, the Minister indicated also that the government had no intention of limiting the operation of the *Dominion Succession Duty Act* to the duration of the war.⁵

Over the last ten years very little has been predictable in the area of tax reform and there must be few who have followed the developments since the publication of the Carter Report who would now be prepared to forecast that the federal government will re-enter the field of capital transfer taxes in the foreseeable future. What does seem to be predictable is that, if this does not occur, Canada will become one of the few developed countries in which unlimited amounts of capital may be passed on from one generation to the

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¹ Federal gift tax is not levied with respect to gifts made after 1971: *Income Tax Application Rules, 1971*, section 140. Similarly, estate tax is not levied with respect to the estates of persons who die after 1971: S.C. (1970-71-72) c. 63 s. 2.

² See, e.g., the discussion in *1971 Conference Report* (Canadian Tax Foundation) at 6-67.

³ *Id.* at 27 (Dan Throop Smith).

⁴ *Id.* at 8 (Richard M. Bird).

⁵ Can.: H. of C. Deb., April 29, 1941, at 2349-50.

next without the taxation of anything but its appreciation in value in the hands of the donor or in those of a spouse predecessor in title. To a large extent, this has already happened. Of the nine provinces which were in the field at the end of 1972, the four Maritime provinces have since withdrawn, British Columbia has announced its intention to withdraw retroactively to January 24, 1977 and a similar statement was made by the Finance Minister of Saskatchewan on March 10 of this year. Unless the government of Quebec reverses the policy of its predecessor, that province will cease to levy either gift taxes or succession duties after the end of 1977.⁶ In Ontario the combined effect of the exemption for estates with an aggregate value of \$300,000 or less, the complete spousal exemption and the provisions which permit forgiveness of duty on family farms and small businesses, has significantly reduced the impact of the *Succession Duty Act*. At the time of writing, Manitoba is the only province in which there is no discernible movement in the direction of abolition. With the withdrawal of the other provinces such a development in Ontario and Manitoba seems almost inevitable.

If the importance of the decision of the Supreme Court of Canada in *Re McCreath*⁷ were to be judged solely against this background it could be described simply as a curiosity: as a case in which several million dollars of duty might well have been collected without litigation under the death tax legislation of almost any other common law jurisdiction but which nearly escaped the net thrown by that misshapen monstrosity — the *Succession Duty Act* of Ontario. The decision is interesting in other respects and these transcend both its facts and the technical questions of interpretation which were in issue.

The decision of Fraser J. at first instance⁸ and some of the specific problems which emerge from the decision of the Supreme Court of Canada have been discussed elsewhere.⁹ The wider implications of the Supreme Court's decision merit a further brief comment. These concern the court's attitude to statutory interpretation, to the doctrine of precedent and to its responsibility to clarify and to declare the law. Of course, one or more of these issues will be relevant in most of the cases which come before the court. The unusual features of *Re McCreath* are that they were raised so starkly, that the opposing arguments were so finely balanced and that the reasoning of the majority of the court on the first and second of the questions departs radically from the approach previously adopted in Canadian cases on death duties.

The sole question which the court had to decide was whether the cor-

⁶ The Quebec Budget of April 12, 1977 announced that "Succession Duties will remain frozen at their present level until the current studies on the income tax structure have been completed."

⁷ *Sub. nom. Minister of Revenue for Ontario v. McCreath* (1976), 67 D.L.R. (3d) 449 (S.C.C.); *rev'g* 37 D.L.R. (3d) 78n; [1973] 3 O.R. 413n; [1976] C.T.C. 178, dismissing on appeal from, 32 D.L.R. (3d) 393; [1973] 1 O.R. 771; [1976] C.T.C. 157.

⁸ [1973] 1 O.R. 771 (Ont. H.C.); 32 D.L.R. (3d) 393; [1976] C.T.C. 157.

⁹ Cullity, M. C., *Re McCreath* (1973), 11 Osgoode Hall L.J. 316; 1 *Provincial Inheritance and Gift Tax Reporter* (CCH) para. 20,028.

pus of a trust created by the deceased some twenty years before her death was deemed to pass on her death for the purpose of succession duty. Like most death tax statutes, the *Succession Duty Act of Ontario* recaptures dispositions *inter vivos* which were made by the deceased if he or she retained an interest in the property until death.¹⁰ In addition, the Act attaches the same consequences to trusts under which the deceased retained a power of resettlement.¹¹ Another provision of the Act exempts *inter vivos* dispositions if the deceased was excluded from the property or from any benefit from it within the five years immediately before death.¹² This also has its counterparts in legislation in other jurisdictions but, in Ontario, it has one important peculiarity. In most death tax statutes the provision is in a positive or recapturing form: it brings back into the notional estate the subject matter of *inter vivos* gifts if the deceased was not excluded from the property or from a benefit within the statutory period. In Ontario the provision is negative in form: it confers an exemption if the deceased was so excluded.

The genesis of these provisions lies in the *Custom and Inland Revenue Acts* of 1881 and 1889 of the United Kingdom. In the parent legislation each was expressed in the positive form and as such they were complementary. If the deceased had disposed of certain proprietary interests in an asset while retaining others for the period of his life the disposition was, in effect, ignored for the purpose of death duties. If, as would usually be the case, he was the absolute owner of the asset prior to the disposition, the value of the absolute interest would be recaptured. The obvious policy behind the provision was to treat as if it were part of the testamentary estate any property in which the deceased retained an enforceable right to possession or enjoyment which would disappear when he died. A disposition with such a reservation of an interest could be regarded as sufficiently close to a testamentary disposition to justify taxation on death.

In its positive form the second provision was treated by the courts as reflecting a legislative awareness that, notwithstanding that no proprietary interest was reserved, a person might still obtain benefits from property of which he or she had disposed. If such benefits were received within the statutory period, the disposition would be ignored to the same extent as if an interest had been reserved. Thus, taken together, the provisions were regarded as recapturing the subject-matter of dispositions if the deceased retained a life interest or received a benefit within the statutory period. This general view of the policy of the provisions allowed them to be construed in accordance with strict principles of property law and, consequently, provided a fair degree of predictability for professionals concerned with estate planning. It will be noted, however, that because the provisions were complementary to each other and did not overlap, it was important that each should be framed as a recapturing provision. If, as ultimately occurred in Ontario, the second provision was turned around and expressed so as to confer an exemption if the deceased was excluded within the statutory period, the traditional approach to

¹⁰ R.S.O. 1970, c. 449, para. 1(r)(x) [S.O. 1960, c. 386, para. 1(p)(viii)].

¹¹ *Id.*

¹² *Id.*, para. 5(1)(g) [*id.*, para. 5(1)(g)].

the construction of the provisions would have the result that a disposition recaptured by the first provision would be exempt under the second. A person who reserved a life interest would normally be excluded from any benefit out of the remainder interests of which he had disposed. Under the second provision it was well established by Canadian decisions as well as those of English, Australian and New Zealand courts that the only relevant benefit was one which arose out of the property interests which had actually been included in the disposition.¹³ A benefit from an interest which had been retained by the settlor would give rise to recapture only under the first of the provisions and this would be of no significance if the corpus would be exempt under the second provision.

The possible flaw in the statute does not appear to have been raised in the years between the enactment of the exemption and the appeal to the Supreme court of Ontario in *Re McCreath*.¹⁴ Despite the many decisions which established the traditional interpretation of the words of the second provision, from a planning viewpoint there was an obvious risk that a court would be reluctant to hold that the first provision was virtually ineffective.

With two qualifications the facts of *Re McCreath* raised the question quite neatly. Under the trust the deceased was, until her death, one of a class of income beneficiaries and might therefore be regarded as having reserved an interest for the purpose of the recapturing provision. As she did not receive any benefit which entrenched upon the capital interest of the persons who were to receive the capital on her death, it could still be argued that the corpus of the trust was exempt.

The first qualification is that the distribution of the income during the deceased's lifetime lay within the trustee's discretion and no beneficiary had any right to demand any amount. On this ground it could be, and was, argued that no "interest" in the strict proprietary sense was reserved by the deceased.

The second qualification arises from the fact that the deceased retained a special power of appointment over the capital. While such a power could not be exercised for her own benefit, there was the possibility that a court might hold that the exemption was lost on the ground that the deceased had not been excluded from the property. On the basis of the earlier authorities it might have been predicted that the beneficiaries would not succeed on the first of these arguments but that the exemption would not have been withheld simply because of the existence of the power of appointment. In the Supreme Court of Canada the beneficiaries were unsuccessful on both points. The first was disposed of in orthodox fashion: English decisions, which extend the normal concept of a proprietary interest to include the "interest" of a beneficiary of discretionary trust of income, were followed.¹⁵

On the second point, the only decision which would seem to give any strong support to an argument for withholding the exemption because of the

¹³ Cullity, Osgoode Hall L.J., *supra*, note 8 at 319.

¹⁴ The possibility was mentioned in Cullity, "Trusts Inter Vivos," *Estate Planning Seminars* (Toronto: York University, 1972) at 44-45.

¹⁵ Cullity, Osgoode Hall L.J., *supra*, note 8 at 318.

retention of the special power was that of *Chick v. Commissioner of Stamp Duties*.¹⁶ In that case the Privy Council distinguished between "exclusion from the property" and "exclusion from a benefit from the property" and held that recapture under a provision in the positive form would occur if the deceased had not been excluded in each respect. The *Chick* case was clearly inconsistent with the approach adopted in earlier Canadian, English and Australian cases and was quickly superseded by legislation in England.¹⁷ Although it was referred to without disapproval by Fraser J. at first instance it was not mentioned in either of the judgments delivered in the Supreme Court of Canada. Each of those judgments adopts an entirely novel interpretation of the words of the exemption.

The court was faced with a considerable dilemma. If the traditional approach to the interpretation of the statutory language was adopted, the recapturing provision would have little, if any, effect. Such a conclusion would be in breach of the normal presumption that Parliament generally intends the words it enacts to have some meaning and application. Yet if the presumption was to be applied and the traditional construction rejected, it would be necessary to attribute a more limited scope to the exempting provision. How was this to be achieved without ignoring completely the words of the Act? Counsel for the Minister produced an ingenious answer which, like the argument for the beneficiaries, relied upon the unusual and tortuous structure of the statute. In order to avoid the possibility that the legislation might be held to impose an indirect tax or one which was not "within the province" the charging section was designed so that the duty is levied either upon property which is situated within the province and which passes on death or upon residents of the province who are the recipients of transmissions or certain lifetime dispositions made by the deceased.¹⁸ This distinction between levying duty on property and levying duty on persons also appears in the opening words of the exempting provision:

No duty shall be levied on any of the following property, . . . nor on any person to whom any of the following dispositions are made, with respect to such dispositions, and such property and dispositions shall not be included in the aggregate value nor included for the purpose of determining any rate of duty, . . .¹⁹

The distinction is continued in the specific paragraphs which follow. Paragraph (a), for example, refers to "any disposition for religious, charitable or educational purposes . . ." while paragraph (b) covers "any property devised or bequeathed by the deceased for religious, charitable or educational purposes . . ." The paragraph in issue in *Re McCreath* read as follows:

Any disposition where actual and bona fide enjoyment and possession of the property in respect of which the disposition is made, was assumed more than five years before the date of death of the deceased by the person to whom the disposition is made, or by a trustee for such person, and thenceforward retained to

¹⁶ [1958] A.C. 435 (P.C.).

¹⁷ See Lauday, D. J. and Mann, E. J. (eds.), *Green's Death Duties* (7th ed., London: Butterworths, 1971) at 141.

¹⁸ R.S.O. 1970, c. 449, section 6 [R.S.O. 1960, c. 386, section 6].

¹⁹ *Id.*, section 5(1) [*id.*, para. 5(1)(g)].

the entire exclusion of the deceased or of any benefit to him whether voluntary or by contract or otherwise;²⁰

As there was no provision which was expressed to exempt property which is the subject matter of such a disposition as distinct from exempting persons who have made such dispositions, and as the Minister had purported to levy the duty on the property, it was argued that there was no exemption applicable to the facts of the case. It will be noted that the argument did not deny that the provision, which in terms confers an exemption upon the recipients of dispositions, was to be given its traditional interpretation; what was denied was its application to cases where duty is levied on property situate in Ontario rather than on persons who are resident here.

Obviously, there was nothing which could be regarded as unorthodox in either of the opposing arguments. The beneficiaries relied upon decisions under very similar provisions in other statutes. The Minister attempted to distinguish those decisions on the basis of the different structure of the statute and of words which had no counterparts in the legislation in other jurisdictions. If there were no other relevant implications in the statute the Minister's argument might well have been regarded as compelling, but it too would have led to anomalous results. In certain cases the Act levies duty on *property* which is situate in Ontario and which was disposed of *inter vivos* by the deceased.²¹ In such cases the duty cannot be levied on the person who receives the property. On the basis of the Minister's argument it would seem that, even though such a disposition might have been made to the total exclusion of the deceased any number of years before the deceased's death, it would be recaptured. It would, of course, be possible for the legislature to intend to impose succession duties on property disposed of absolutely and without strings fifty years before the deceased's death but this would be unusual; it would create considerable difficulties for the deceased's personal representatives and it would be anomalous in the light of the exemption given to persons who are the recipients of other lifetime dispositions.

In the result, therefore, the Supreme Court of Canada was faced with two quite powerful arguments constructed along quite orthodox lines. One argument supported the existence of an exemption; the other led to a denial of any exemption; and each would have produced anomalous results. In such a situation an observer might have been justified in thinking that previous cases indicated how such a difficulty in the construction of a taxing Act and, in particular an Act which imposes death duties, would be resolved. The principle was stated by Schroeder J.A. in *Re Odette*:²²

Even if I am in error in the construction which I would place upon the provisions . . . , it is at least highly doubtful that the language of the enactment extends unambiguously to [the property in question]. . . . In that view the case is one of doubtful interpretation and the doubt should be resolved in favour of the respondent.²³

²⁰ *Id.*, para. 5(1)(g) [*id.*, para. 5(1)(g)].

²¹ *Id.*, paras. 1(r)(xi), 1 (r) (xii) [*id.*, paras. 1(p)(ix), 1(p)(x)].

²² [1965] 2 O.R. 713 (C.A.).

²³ *Id.* at 719-21 and see McGillivray J.A., at 721.

The judgment of the Supreme Court of Canada was reserved for almost twelve months. When delivered, it reversed the decision of the Ontario Court of Appeal and held that the exemption was not available. The court rejected both the traditional interpretation of the words of the relevant provision and the Minister's argument that it did not apply where duty was levied on property situate in Ontario. A third alternative construction was approved.

The foundation of the argument for the beneficiaries was that the "property" from which the deceased had to be excluded consisted of the particular proprietary interests which were comprised in the disposition. As interests which she had reserved were not included in the subject matter of the disposition, any benefit derived from such interests would not exclude the application of the exemption. It followed that her receipt of income within the five year period was irrelevant. Despite the numerous authorities which provided strong persuasive support for this interpretation,²⁴ it was rejected. The court held that the property which had been disposed of consisted of the common shares which the trustees had received.²⁵ By virtue of her receipt of income from the shares the deceased had benefitted from the subject matter of the disposition. In addition the existence of the special power of appointment over the shares was regarded as sufficient to justify the conclusion that she was not excluded from the property.

Whenever the donor fails to divest himself or herself of control of or income benefits from the property, the section is inapplicable to exempt from tax, . . .²⁶

Obviously, there is much that is attractive in this approach. In the past, judicial attitudes to the construction of death tax statutes in Canada, and in other Commonwealth countries, have been notorious for their excessive positivism.²⁷ As a result tax avoidance schemes have been designed and upheld on the basis of the most convoluted arguments, the most arid technicalities and the most esoteric principles of property law.²⁸ In *Re McCreath* this

²⁴ See the discussion by Fraser J.: [1973]1 O.R. 771 (Ont. H.C.) at 786-95.

²⁵ *Supra*, note 6 at 465 (Dickson J., (1976), 67 D.L.R. (3d) 449).

²⁶ *Id.* at 446.

²⁷ "What does this come to? It means that, in order to avoid estate duty, the lawyer turns magician. He advises his client to execute a revocable settlement, and in an instant, before our very eyes, the contingent capital interest is gone. No one can see it. It is replaced by a continuous life interest. No estate duty is payable. And then, whilst we sit admiring the performance, wondering what is coming next, he can, when he pleases, bring back the capital interest. He advises his client to revoke the settlement, with, of course, the consent of his co-trustee, and at once the capital interest is there intact. It makes me rub my eyes. I cannot believe it is true. Those near me acclaim the feat. But I do not. I have a feeling that the contingent capital interest remained there all the time, cloaked by a revocable sub-settlement. Pull the covering aside and you will see it as it really is, a contingent capital interest which became absolute on the father's death; and on which, therefore, estate duty is payable." : *Morgan v. Inland Revenue Commissioners*, [1963] Ch. 438, at 458 *per* Lord Denning M.R. (dissenting); "The argument in this appeal is not about 'How many angels can stand on the point of a needle'. It is about £26,000"; *Re Kilpatrick's Policies Trusts*, [1966] Ch. 730, at 763 *per* Diplock L.J.

²⁸ E.g., in *Re Kilpatrick's Policies Trusts*, *supra*, note 26, the decision turned on the application of the rule in *Phipps v. Ackers* (1842), 9 Cl. & Fin. 583 (H.L.) and the distinction between contingent interests and interests which are vested but liable to be divested.

approach was repudiated with some emphasis.²⁹ In this respect the reasoning in the decision is consistent with the general trend in the Supreme Court's attitude towards the construction of other taxing statutes over the last ten years and in both its style and content it bears a much greater similarity to judgments in the Supreme Court of the United States than to those of the courts of other Commonwealth countries.

This radical change in the court's approach to the question of construction was achieved at the expense of certainty and predictability. Only the *dictum* which is quoted above provides any guidance as to the status of earlier decisions and of other dispositions and transactions which had previously been thought to be exempt.³⁰ Chief Justice Laskin has recently stated that an "appellate court, and certainly a final appellate court, is charged not only to decide the immediate case but also to declare the law of the province or of the country, as the case may be."³¹ In this respect both the majority and minority judgments are open to the same criticism which has been levelled at the court so often in recent years.³² Unless litigation is to be encouraged it is important that the court should not only give reasons for its decisions but should attempt to state them with a precision which is sufficient to provide guidance for lower courts and for individuals and their professional advisers.

One other general consideration might be mentioned. The court has an obligation to give effect to Acts of Parliament and it has recognized that this responsibility will not be discharged by placing the sole emphasis on the dictionary meaning of the words chosen by the draftsman. In recent cases the court has placed considerable reliance on what it conceived to be the purpose or mischief at which a particular statutory provision was directed. The view that a judge has no authority to attempt to fill gaps in a statute has become somewhat unfashionable. Yet, to quote Chief Justice Laskin again:

... if there is incompatibility between purpose and the language used to express it, the latter must govern.³³

In *Re McCreath* there seems to be no doubt that the problem was created because of a major defect in the way in which the statute was drafted. It was not a case of a simple omission or ambiguity; it was a fundamental defect which would almost certainly have been removed if the significance of the decisions in other jurisdictions had been appreciated when the exempting provision was enacted. If the courts have accepted their authority to fill legislative gaps, it does not follow that they should re-write statutes in order to remedy legislative errors. Where the statute is notoriously badly drafted and

²⁹ *Supra*, note 6 at 461 ((1976), 67 D.L.R. (3d) 449).

³⁰ See I *Provincial Inheritance and Gift Tax Reporter* (CCH) para. 20,028.

³¹ "A Judge and His Constituencies" (1976), 7 *Manitoba Law J.* 1 at 5.

³² For a discussion of a recent example of the confusion caused by the court's reticence, see (1976), 3 *Estates and Trusts Quarterly* 93 (R.E.S.).

³³ *Supra*, note 30 at 9.

where successive governments have ignored strong recommendations for its complete revision,³⁴ there was surely something to be said in justification of judicial restraint. Those who are in favour of death taxation and who applaud the court's repudiation of a rigid application of proprietary concepts but who, at the same time, believe that the statute in Ontario should either be revised or be replaced might well regret that restraint was not exercised in *Re McCreath*.

³⁴ See 3 *Report of the Ontario Committee on Taxation* (Toronto: Queen's Printer, 1967) at 146-47; *Report of The Advisory Committee on Succession Duties* (1973), ch. 2.