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Beament v. *M.N.R.*
ESTATE PLANNING — ESTATE FREEZING — "DISPOSITION" — *Gift Tax Act* — MANAGEMENT COMPANY

The late James Gow, Q.C. used to say about tax planning and particularly estate planning, "It is important to leave footprints, but it is even more important that the footprints you do leave should all point in the same direction." The wisdom of this admonition, and the importance of meticulous care in complying with the precise provisions of the taxing statutes are well illustrated by four fairly recent decisions, three by the Supreme Court of Canada and one by the Court of Appeal of Ontario.

On balance, the batting average of each side was an even .500; the taxpayer won two and lost two. It is not without significance that the two that were lost were both cases of faulty estate planning in which the deceased seems to have acted without professional assistance. On the other hand the two cases won by the taxpayer, an estate tax case and an income tax case, both bear the stamp of professionalism; the people who laid the plans knew what they wanted to do, and how to do it.

The earliest of these cases in point is *Beament* v. *M.N.R.*[1] It involved the provisions of the old *Estate Tax Act*[2] but is equally relevant to the Succession Duty Acts. The deceased, A. W. Beament, undertook what is known in the trade as a "freezing" operation with respect to his estate. He transferred substantial assets to a holding company taking in exchange demand notes and 2,000 class B shares of a par value of $1.00 each; his two grown children each subscribed for 12 class A shares also of $1.00 par value. The letters patent of the company provided that the class A shares were entitled to a preferrential dividend of 5% but that all the income earnings of the assets of the company other than capital gains, were to belong to the class B shares. All shares had equal voting rights which meant the class B shares effectively controlled the company, although on winding up they were entitled to their par value and no more.

Obviously, the voting control of the B shares and its possible effect on valuations caused the planners some concern so, contemporaneously with the incorporation they caused the deceased to enter into an agreement with his two children that he would, by his will, direct his executors to see that on his death the company's debts were paid and proceedings taken to distribute its assets. The deceased complied with this undertaking and on his death the company was in fact wound up, his estate receiving $8,725.98 on account of income accrued to the date of his death plus $2,000.00 par value for his shares, or a total of $10,725.98.

On the death of the deceased no question was raised about the adequacy of the consideration he had received from the company for the assets transferred to it, the sole question being the fair market value of the B shares. It was the Minister's contention that in determining such value the terms of the agreement for the winding up of the company should be disregarded.

1 [1970] S.C.R. 680, (1970), 11 D.L.R. (3d) 237.
2 S.C. 1958, c. 29.

Since the B shares were entitled to practically all the income earned on its assets if this contention was correct, it was obvious the shares had a value greatly in excess of the $10,725.98 the executors had in fact received and it was conceded that $110,000.00 would in that event, be a reasonable valuation.

By a process of reasoning which may not unfairly be described as somewhat metaphysical Jackett P. in the Exchequer Court gave effect to the Minister's argument. The Supreme Court, however, adopted a more direct approach "once it is established (and it has been conceded) — that the contract binding the deceased and his executors to have the company wound up was valid, the real value of the shares cannot be more than the amount which their holder would receive on winding up."[3]

This might be thought to be all that needed to be said but it wasn't quite. Pigeon J. while concurring in the result put things differently. He considered that the agreement between the deceased and his children was a "disposition" within the meaning of that term as defined in the Act and that, had it been entered into within three years of the death of the deceased, it would have been taxable, but that, as it was made more than three years before his death, it was exempt.

This approach raises problems for anyone who intends to follow the same pattern. Because clearly the contract would seem to fall within one, at least, of the definitions of what constitutes a disposition contained in the Ontario *Succession Duty Act*[4] namely, "any means whereby any person is benefitted directly or indirectly by any act of the deceased during the lifetime of the deceased."[5]

The next question is whether a contract of this sort would attract gift tax. No claim for gift tax appears to have been made in the *Beament* case but that doesn't necessarily mean no such claim would be made by Ontario in a later case. One of the definitions of property in the Ontario *Gift Tax Act*[6] is "a right of any kind whatever", and Pigeon J. thought these words made the right conferred on the children "property" within sections of the *Estate Tax Act* that are reproduced in more or less identical language in the Ontario *Gift Tax Act*. It would appear, therefore, that such a contract would probably give rise to gift tax, although on what basis of valuation might be open to question. Truly the way of the estate planner is hard, and perhaps the planners in the Beament estate were lucky as well as skillful.

But if the way of the professional planner is hard, that of the amateur can be cruel indeed. Sad, if simple, examples are two of the other cases referred to: *M.N.R.* v. *H. Cox Estate*[7] and *Re Chodikoff*.[8] In the first of these cases the deceased purported to sell a life insurance policy for the face amount of $50,000 to the beneficiary thereof for the cash surrender value thereof,

3 (1970), 11 D.L.R. (3d) 237 at 242.
4 R.S.O. 1970, c. 449.
5 R.S.O. 1970, c. 449, s. 1(g)(ii).
6 S.O. 1972, c. 12.
7 71 C.T.C. 227 (S.C.C.).
8 [1971] 1 O.R. 321 (C.A.).

making a gift to her of that amount, plus the amount of the next year's premium. The method used was the time honoured one of an exchange of cheques but there was no interval of time between the two sides of the transaction and no arrangements made to provide funds on deposit to meet the cheques had they been presented separately. These circumstances were enough to cause the Supreme Court to say:

> . . . [T]he exchange of cheques was merely the machinery used to effect a gift of the policy by the deceased to his wife. The simultaneous exchange of cheques where neither would be honoured due to insufficient funds were it not for the offsetting entry of the other cheque can only be viewed as a single transaction.[9]

It seems a bit harsh and technical when what the people were trying to do was clear enough, but it is often said there is no room for a liberal construction of a taxing statute.

There was also none in the *Chodikoff* case. There the deceased had again undertaken a freezing operation with a holding company in which trusts of which his wife and children were the beneficiaries owned all the shares of the company that could benefit from an increase in the value of the assets. Unfortunately he was most careless in the manner in which he transferred to this company the assets, the value of which he wanted to freeze. This transfer was in part effected by a transfer by the deceased of shares in a realty company at much less than their true value and in part by allowing the holding company to subscribe for additional shares of the realty company also at less than their true value.

These transactions admittedly gave rise to a taxable disposition; the question in the case was, not whether the disposition was taxable, but at what rate. Since those who actually benefitted by the disposition were the wife and children of the deceased, it was argued that the tax should be levied at a lower rate applicable to members of the immediate family and not at the stranger's rate which would have been applicable if the disposition was regarded as in favour of the company. In other words, in the fashionable phrase, the Court was invited to "pierce the corporate veil". The Court of Appeal refused to do so. In one of the first judgments he delivered after joining the Court, Arnup J. A. said:

> No property interest accrued to the trust, either at law or in equity, by reason of the disposition. The only effect was that in certain events an asset which it already held might become more valuable.[10]

In the last and latest of the four cases mentioned earlier, *M.N.R.* v. *Cameron*,[11] it was the Minister not the taxpayer who wanted to thrust aside the incorporated company and in this he also failed. This was an income tax case and arose as the result of arrangements made by the sole shareholder of a construction company to enable three of its key executives to acquire an interest in it. Rather than dealing with the three individually, this shareholder preferred that a company should be formed with the three as shareholders, that it should agree to furnish management services to the contracting company

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9 71 C.T.C. 227 at 229.

10 [1971] 1 O.R. 321 at 330.

11 72 D.T.C. 6325 (S.C.C.).

and that it should be compensated by receiving an amount equal to the total salaries of the executives plus 15% of the net profit of the contracting company which it would use to purchase shares from the shareholder. The three executives became officers of the management company and resigned as employees of the contracting company although they retained their respective titles so there was no ostensible change in the operations. It will be observed that although this arrangement resulted in a saving of income tax compared with the amount that would have been payable had the 15% of profits been divided among the three executives as individuals, the evidence, accepted by the trial judge, was that the primary purpose was not tax avoidance but the design of an efficient method by which these executives, and possibly others later on, could acquire a share interest in the contracting company. Notwithstanding this finding, the Minister characterized the whole transaction as a sham and assessed the individuals in disregard of the management company. Having failed in the Exchequer Court, the Minister carried his submissions to the Supreme Court of Canada where he also lost. Perhaps if the scheme had been held to be for the purpose of tax avoidance he might have succeeded.

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