

# The New Estate Tax Act

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Commentary

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## Notes

THE NEW ESTATE TAX ACT<sup>1</sup> has provided an entirely new concept in the taxation of estates by the Federal Government. The previous Succession Duty Act enacted in 1941 was in essence merely a collocation of the various provincial Succession Duty Acts, and because of this the primary liability was based on the succession and not on the estate itself. This was a necessary feature of the various provincial Acts because of the provisions of the British North America Act which precluded the Provinces from levying an "indirect" tax. On the other hand, the Dominion government is not hampered by any such restriction—it has full power to impose a tax which will be passed on to another party. The new Estate Tax Act recognizes and predicates this most significant distinction and therefore it has been able to evolve a far more sensible and practical approach to the problem of estate tax. In the new Act, the tax is levied on the estate itself and the primary liability for payment rests with the executor of the estate.

The new Act provides for several changes in the taxability of various items and in the computation of the tax itself. The writer feels that some of the more important changes in the new Federal Act are worthy of comment.

### *Real Estate*

One of the most important innovations is the provision which extends the duty on real property to realty situate outside Canada.<sup>2</sup> To the writer's knowledge, this is the first jurisdiction to enact such a provision. A necessary complement to this new provision will be alterations in the various reciprocal Tax Treaties to which Canada is a party. Up to the present, most of these treaties have made provision for the exemption of foreign real estate from the estate tax of the county of domicile. The modern day development of the reciprocal agreement has rendered obsolete the necessity of the exclusion of foreign realty. The new provision will obviate the former practice of buying realty in "tax-havens"<sup>3</sup> where there is little or no duty on the property of a deceased. Where there is a duty in the foreign jurisdiction there is now provision in Section 9 of the Act for a credit which, however, will not exceed the Canadian Tax which is leviable on that portion of the estate.

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<sup>1</sup> An Act Respecting the Taxation of Estates, a federal enactment repealing the Dominion Succession Duty Act and proclaimed on the 1st day of January, 1959.

<sup>2</sup> In a press release issued on the 12th of December, 1958, the Minister of Finance announced that discussions would take place between Canada and the United States in respect of the Death Duty convention existing between them. The discussions are to establish modifications of the convention in the light of the New Estate Tax Act.

<sup>3</sup> e.g., The Bahamas.

### *Estate Planning*

As mentioned above, under the old Act the taxation formula was calculated on the various distributions which were made. There were two rates of tax imposed, an initial rate and an additional rate divided into four categories or classes. The amount of tax varied according to the relationship of the deceased to the beneficiary and according to the size of the beneficial interest which passed. Close relations of the deceased were taxed at a preferential rate and thus the tax would be considerably lower than if the beneficial interest had passed to a stranger. The estate planner would mould the will drafting the various provisions that were to be made with an eye to attracting the least possible death duty, i.e. by the splitting of successions. Under the new Act it will no longer be necessary to make a separate evaluation of life interests and remainders, as such splitting of succession has been eliminated. There will be only one tax no matter when the estate is distributed.

It is of interest to the profession to note that under the new Act, there is a shift in emphasis in the function of the estate planner. It would appear that when dealing with the new Act many of the objectives mentioned above will be achieved through a more expanded gift programme and will depend less on the drafting of the will itself. The amount of duty will remain constant no matter to whom the estate is bequeathed. Thus the minimization of tax would seem to have to stem from inter vivos disposition.

A further result of the new Act is that the family protection embodied in the old Act is abolished. Thus there is no preferential rate with respect to the relatives of the deceased. It has been argued that this is only a theoretical change since where there is a higher initial exemption, as provided in certain instances under the new Act, the estate is nearly always left to the members of the family involved. However it should be noted that the higher initial exemption applies to a narrow field, namely when there is a widow, or an infirm husband, or dependent children involved, and therefore the same results as under the preferential rates scheme in the old Federal Act are not achieved. Thus where the survivors are a healthy husband, or adult children, etc., the tax will probably be slightly higher than under the old Act.

### *Gift Programmes*

There are many advantages in making use of a gift programme in order to reduce death duties. It is the writer's view that these advantages take on an added importance when one considers that the rate of taxation applicable at present is neither a function of the size of the bequest nor of the relationship of the beneficiary.<sup>4</sup> Among

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<sup>4</sup>It should be noted that under similar provisions of the English Act, the whole estate is taxed on the death of the testator and again on the death of the life tenant. Whether this will be so under the New Canadian Act is an open question. But see on this point, a commentary by John Graham, Q.C. in *The Canadian Tax Journal*, Jan.-Feb. 1959.

the many benefits of a gift programme the following are most worthy of attention:

(i) The use of this scheme will result in a reduction of the size of the eventual "estate."

(ii) Gift taxes are in most instances lower than estate duties.

(iii) The reduction of the capital in the eventual "estate" will result in a consequent reduction in the amount of accruals to capital.

Such factors as appreciation in the value of assets and the resultant income on those assets must be considered. By the making of gifts one can effect a "freezing" operation on the estate. This freezing arises where an estate consists primarily of shares of a private company. If this company is developing there will be a problem of having liquid assets to pay succession duties. Freezing is carried out by selling the equity in the company to the heirs and taking in return some asset which will render security of income but one from which the growth factor is eliminated.

In the adoption of such a programme, timing is an all important element. The testator can not give too much away early in life or his ability to increase his assets will be hampered by lack of capital. On the other hand, it must be initiated at some reasonable time before death in order to achieve the substantial benefits which can be obtained.<sup>5</sup>

As under the old Act, gifts made within a period of three years prior to death are included in the net value of the estate. This includes gifts made beyond the three year period where actual and bona fide possession is not completely transferred prior to the three year period. The new Act extends this by the use of the word "disposition" to include certain dispositions which are gifts in effect but not in form.<sup>6</sup>

Where gifts are included in the estate of the deceased for estate purposes, the property of the gift is to be valued at its worth at the date of any subsequent transfer by the recipient during the lifetime of the deceased.<sup>7</sup> (Under the old Act the gift was to be valued at the date of death.) Where a gift of shares in a corporation, given by the deceased during his lifetime, is included in the estate, the amount of any stock dividends accruing to those shares during the deceased's lifetime must be added to the value of the shares.<sup>8</sup>

#### *Life Insurance*

The new Act determines the taxability of insurance proceeds on an ownership basis. This is an alteration from the former Succession

<sup>5</sup> See, Little, Non-Trust Gifts, Special Lectures, Law Society of Upper Canada (1957).

<sup>6</sup> It should be noted that by section 41 of The Income Tax Act (1958), a donor can make a once in a lifetime tax free gift. This can be of the value of upward to \$10,000.00 and must be composed of real property. Such a gift can be made only to the spouse or child of the donor. Where the gift is to the spouse, the property is to be used as a place of residence; where the gift is to a child, the property is to be used as farmland.

<sup>7</sup> Estate Tax Act, 1958, c. 29, s. 3(1)(d).

<sup>8</sup> *Ibid.*, 1958, s. 30.

Duty Act which used the "premium test", i.e. who paid the premiums or who maintained the policy? Thus the relevant section provides that insurance on the life of the deceased will be subject to tax where immediately prior to death the policy is owned either alone or jointly with another person by the deceased or under a trust the terms of which are subject to alteration by the deceased. Tax will also be levied where the policy is owned by a corporation controlled by the deceased where the proceeds are payable to the spouse, or children or a trustee for their benefit.<sup>9</sup> The concept of "ownership" in the new Act appears to be related to the concept of control and thus one who has power, directly or indirectly (through a controlled corporation), to change the beneficiaries or pledge the policy as security would be classified as an owner.

In respect to the taxability of life insurance,<sup>10</sup> it would appear advantageous for a husband to transfer his insurance policy to his wife, thereby constituting a gift of the cash surrender value of the policy at that date. In subsequent years the husband would make a gift to the wife of a sum large enough to pay the annual premiums which come due. However, it is arguable that this practice would be caught by Section 3(i) (j) of the new Act; "Any annuity or *other interest purchased or provided by the deceased.*" The situation could be remedied at the outset by having the husband make a gift to the wife of the amount necessary to pay the initial premium and having her place the policy. This would avoid any problem arising under Section 3(i) (j).

#### *Procedure*

One of the innovations of the new Federal Estate Tax Act is that its provisions vary depending on the domicile of the deceased. Thus, the estate tax regarding persons domiciled outside Canada is dealt with separately under Part 11 of the Act, and shall be dealt with later in this article. Comment will first be directed to the estates of persons domiciled in Canada. There have been various procedural changes under the new Act, most of them aimed at achieving a coordinated system of Dominion taxation. Thus certain provisions have been introduced to tie Estate Tax in with Income Tax procedures.

The method of objection in Section 22<sup>11</sup> is virtually the same as under the Income Tax Act. By section 23 an appeal from an assessment will lie to the Tax Appeal Board after the Minister has confirmed the assessment, or re-assessed it, or after one hundred and eighty days have elapsed from the service of a notice of objection. However no appeal may be instituted after ninety days have elapsed from the time the Minister confirms or reassesses. This method is similar to that used in Income Tax Appeals.<sup>12</sup> It should be noted that the Tax Appeal Board is constituted by the Income Tax Act and until 1958 was known as the Income Tax Appeal Board. The 1958 amendment<sup>13</sup>

<sup>9</sup> *Ibid.*, s. 31.

<sup>10</sup> *Ibid.*, s. 3(1) (m) and s. 3(1) (m) (ii).

<sup>11</sup> *Ibid.*, s. 3(1) (m).

<sup>12</sup> *Ibid.*, s. 3(1) (m).

<sup>13</sup> Income Tax Act, R.S.C., 1952, c. 29, s. 59.

changing its name was a reflection of the desire to include all tax matters within its jurisdiction. This method will enable more individuals to have their assessments reconsidered because of added convenience and reduced costs.<sup>14</sup>

Section 17 provides that the liability to pay any amount of tax within the time allotted will not be affected by the fact that an objection or appeal is then outstanding. Thus the correct procedure is to pay the tax and obtain a refund with interest at the rate of 5% if the objection or appeal is successful. This provision is also similar to that under The Income Tax Act.<sup>15</sup>

### *Persons Domiciled Outside Canada*

Where the estate is that of an individual who dies domiciled outside of Canada, only the property situate in Canada is subject to tax. The rate of tax is 15% of all property situate in Canada without allowance for debts unless they are debts or encumbrances secured by or charged upon the property. There is an initial exemption of \$5000 and thus where the total value of the property in Canada does not exceed this amount, no tax will be payable.

### *Rules of Situs*

In the new Act the rules of situs are written into the Act for the first time, and detailed rules of situs have been set out for the calculation of provincial tax credits.<sup>16</sup> These rules are not the same as those which are applied to determine the situs of property which is subject to Canadian Tax but owned by a person who at the date of death is not domiciled in Canada.<sup>17</sup> In this computation, property found in Canada at the date of death and which would be deemed to pass on death under Part I of the Act will have to be included in the value of the property situate in Canada. Where there is a provincial duty applicable to the same property, a 50% credit will be allowed.<sup>18</sup>

### *Conclusion*

The above paragraphs are not intended in any way to be a detailed analysis of the provisions of the Estate Tax Act. Rather it is intended to be a short synopsis of the changes involved in the new legislation. The new Act is not a panacea for the difficulties inherent in estate tax legislation. However, it is submitted that it is a step forward towards a more realistic and progressive approach to the problem.

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<sup>14</sup> *Ibid.*, s. 22.

<sup>15</sup> Section 24 of The Estate Tax Act enables the decision of the Tax Appeal Board to be appealed to The Exchequer Court of Canada. This, however, is a trial *de novo*, the court not being bound by the Board's proceedings. Section 24(2) of the same act also evaluates an assessment to be appealed directly to the Exchequer Court, without resort to the Tax Appeal Board.

<sup>16</sup> Income Tax Act, R.S.C., 1952, c. 29, s. 51.

<sup>17</sup> Estate Tax Act, 1958, c. 29, s. 9(8).

<sup>18</sup> *Ibid.*, s. 38.