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THE TAXATION ON DEATH OF ANNUITIES
AND OTHER INTERESTS

H. L. E. WHITE®

"Whenever property changes hands on death, the state is entitled to step in and take toll [of the property of the deceased]."

The words quoted above are those of Lord Justice MacNaghten in *Earl Cowley v. Inland Revenue Commissioners*¹ and were made in reference to the Finance Act (U.K.) 1894.² These words set the guidelines and indicate the basis on which death taxes are levied, not only in the United Kingdom, but also in Canada.

The revenue statutes do not, at present, tax all property which changes hands on the death of the deceased. It is thus the function of the statute which imposes death taxes to set out, with particularity, what property is, and what property is not, liable to be caught in the revenue net. It is in the area of defining property taxable on death that difficulties have appeared. It is thus not surprising to find that much of the case law relating to death taxation has been concerned with the definitive sections of the relevant statutes.

This study is written for the purpose of examining the problems (and the solutions which have been devised for them) which have arisen in relation to the taxation of one particular type of property, namely "annuities" and "other interests" which pass on death and which have been purchased or provided by the deceased. In order to discuss these problems with any degree of clarity it will be necessary to refer to various decisions of the Courts on the subject, both in the United Kingdom and Canada. On the basis of such an analysis, it is the writer's hope that some light will be shed on the subject and perhaps the reader will then be able to determine those instances in which "annuities" and "other interests" will be subject to taxation on death in the future.

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² 57-58 Vict. c. 30. This is the British precursor of our Estate Tax Act.
Annuities and other interests are taxable under both the Ontario Succession Duty Act\(^3\) and the Estate Tax Act.\(^4\) It would perhaps be convenient to set out, at this point, the relevant provisions of these Acts.

Section 1(p) (ii) of the Ontario Succession Duty Act provides:

In this Act, property passing on the death of the deceased is deemed to include . . . any annuity, income or other interest purchased or in any manner provided by the deceased either by himself alone or in concert or by arrangement with any other person to the extent of the interest therein accruing or arising on the death of the deceased.

The parallel provision of the Estate Tax Act, section 3(1) (j), provides that:

There shall be included in computing the aggregate net value of the property passing on the death of a person the value of all property wherever situated, passing on the death of such person, including, without restricting the generality of the foregoing, any annuity or other interest purchased or provided by the deceased, either by himself alone or in concert or by arrangement with any other person, to the extent of the beneficial interest therein arising or accruing by survivorship or otherwise on the death of the deceased.

The careful reader of these two sections will notice that while the provisions are substantially the same, the terms of section 1(p) (ii) would appear to be wider than those of section 3(1) (j) in that: (1) the former taxes “income” specifically in contrast with the terms of section 3(1) (j) which makes no reference to the word; and (2) the terms of section 1(p) (ii) tax property “to the extent of the interest accruing”, whereas section 3(1) (j) is restricted to the “beneficial interest arising or accruing”.

Jameson, in his text, *Ontario Succession Duties*, remarks on the latter distinction as follows:

The [Succession Duty] Act does not include the word ‘beneficial’ but it is our view that this does not detract from the meaning of the subsection.\(^5\)

It is submitted that, far from detracting from the meaning of the sub-section, the terms of section 1(p) (ii) express the meaning and purpose of the legislature with greater exactness and clarity than does section 3(1) (j) which must be read in the light of judicial interpretation of the section.

Before any comment may be made on the judicial interpretation of these sections, the terms of section 2(1) (d) of the Finance Act (U.K.) 1894,\(^6\) which served as a model for both the Ontario and Federal provisions, should also be set out:

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\(^3\) R.S.O. 1960, c. 386. Annuities and other interests are taxed at death on the same principles in the provinces of British Columbia and Quebec as well.

\(^4\) S.C. 7 Eliz. II c. 29 as amended.


\(^6\) *Supra*, footnote 2.
Property passing on the death of the deceased shall be deemed to include the property following, that is to say:—

any annuity or other interest purchased or provided by the deceased alone or in concert or by arrangement with any other person to the extent of the beneficial interest accruing or arising by survivorship or otherwise on the death of the deceased.

Reference is made to this particular section, which is the same in effect as section 3(i) (j) of the Estate Tax Act, because much of the case law which will be discussed in this paper is British in origin.

It will now be in order to determine the meaning and application of these provisions. Lord Chancellor Loreburn, stated in a frequently quoted passage in the case of *Lethbridge v. Attorney-General* with reference to section 2(1) (d) that:

The general purpose of this sub-section is to prevent a man escaping estate duty by subtracting from his means, during life, moneys or money's worth, which, when he dies, are to reappear in the form of a beneficial interest accruing or arising on his death.

The present Ontario Succession Duty Act and the Estate Tax Act have other provisions performing the same function, i.e. those sections which specifically tax insurance proceeds. These sections are discussed briefly at a later point in this study.

In the leading case of *D'Avigdor-Goldsmid v. I.R.C.*, Lord Morton indicated in the course of his judgment that three conditions must be satisfied before the terms of s. 2(1) (d) would be applicable:

(i) There must be an annuity or 'other interest'; (ii) It must have been purchased or provided by the deceased, either by himself alone or in concert or by arrangement with any other person; and (iii) A beneficial interest therein must accrue or arise by survivorship or otherwise on the death of the deceased.

To determine the meaning of these sub-sections, it is proposed that each of the requirements set out by Lord Morton be considered separately in conjunction with the applicable case law.

The first requirement is that “there must be an annuity or other interest” in the property subject to taxation. The first problem, then, would appear to be to determine what an “annuity” is. Briefly, an annuity is

a yearly payment of a certain sum of money granted to another in fee, or for life, or for a term of years, either payable under a personal obligation of the grantor or charged upon his pure personality, although it may be made a charge upon his freehold or leasehold land...10

In addition, it should be noted that an annuity may be a charge on the corpus of an estate and, if it is, the annuitant may, if the income is insufficient, require a sale of a sufficient part of the corpus to keep up the value of the annuity. Further, an annuity may be created by will and if it is so created, it commences, unless otherwise

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7 [1907] A.C. 19 at 22.
provided, from the death of the testator, and, unless otherwise directed, the first payment is to be made one year after the testator's death.

The second problem is to ascertain the meaning of the phrase "or other interest" as it is used within the context of the sub-sections under consideration. According to the Canadian Estate and Gift Tax Reporter:

The words 'or other interest' are extremely wide, and under the corresponding English legislation ... those words have been considered wide enough to cover insurance.

The authorities cited for this statement include the cases of Re Gass-ton and Re MacPhayden. However, it should be noted that insurance proceeds payable on the death of the deceased will not always be taxable under the terms of sections 1(p)(ii) and 3(1)(j).

In the Manitoba case of Re Gasston, a decision of Mr. Justice Dysart, the facts were that an accident insurance policy in favour of the insured's wife had been taken out by his employer who had paid all the premiums on the policy. The insured had taken no real part in arranging for the policy, and the payment of the premiums by the employer in no way affected the remuneration of the employee. The insured died as a result of an aircraft accident while on his employer's business and the insured's wife, as beneficiary, received the proceeds of the policy. One of the issues before the Court was whether such proceeds were taxable under s. 3(g) of the Manitoba Succession Duty Act which corresponds with section 3(1)(j) of the Estate Tax Act.

The learned judge, after examining the relevant decisions of the British Courts held:

These high authorities all held that life insurance policies—or moneys payable under them to a donee or beneficiary—fall within the expression 'interest' and is taxable as property passing on the death of the insured.

However, since the policy in this case was not purchased or provided by the deceased, by himself or in conjunction with others, all the conditions of the sub-section (noted supra) were not met, with the result that the proceeds were not taxable.

Mr. Justice Dysart refused to accept the argument that the rule of ejusdem generis applied in interpreting the phrase "other interest", on the basis of the British cases considered by him. Thus, the effect of the Re Gasston decision was to extend the scope of the phrase "other interest" to cover not only life insurance policies but also accident insurance policies which matured on the death of the insured.

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11 Re Eobbins, [1907] 2 Ch. 13.
12 Houghton v. Franklin (1826), 1 Sim. & S. 390.
14 [1943] 2 D.L.R. 220.
16 See D’Avigdor-Goldsmid v. I.R.C., discussed infra.
17 [1943] 2 D.L.R. 220 at 223.
provided that they were purchased or provided by the deceased and a beneficial interest therein accrued or arose at death.

The Ontario case of Re MacPhayden decided by Mr. Justice Hope and affirmed on appeal followed the decision in the Gasston case, both in time and in principle. The issue before the Ontario Court was whether or not the proceeds of an accident insurance policy on the life of the deceased were taxable under the terms of section 8(2)(e) of the Ontario Succession Duty Act. Section 8(2)(e) of the Act, at that time, was expressed in the same terms as the present section 3(1)(j) of the Estate Tax Act. In this case, the premiums on the policy had been paid by the deceased who was subsequently killed in an accident.

Mr. Justice Hope held that the proceeds of the policy were taxable since they constituted an “other interest” within the terms of section 8(2)(e). In the course of his judgment, his Lordship quoted with approval the following excerpt from the judgment of Chief Baron Palles in the case of Attorney-General v. Robinson:

‘Interest’ here must plainly mean interest in property. . . . The thing subjected to taxation is ‘the beneficial interest accruing or arising by survivorship or otherwise, on the death of the deceased, in any annuity or in any other interest in property purchased or provided by the deceased’ as mentioned in the section. The words ‘accruing or arising’ are used in contradistinction to ‘passing’. They indicate, not the transfer upon death to another of something which the deceased or some other person had before or at the death, but the springing up, upon the death, and the then vesting in another, of property which previously had not been existing in any one. This is an exact description of money secured by a policy of insurance.

On the basis of the foregoing analysis it would thus appear that the term “other interest” as found in sections 1(p)(ii) of the Succession Duty Act and 3(1)(j) of the Estate Tax Act will not be interpreted subject to the rule of ejusdem generis which rule would restrict its meaning, but will be interpreted as broadly as possible in order to bring any interest in property, otherwise taxable under the sections, within the reach of the Revenue net.

The second condition noted by Lord Morton in his judgment in the D’Avigdor-Goldsmidt case is that the amount must have been “purchased or provided by the deceased, either by himself alone or in concert or by arrangement with any other person”. The terms of the condition would seem to imply that if the interest is purchased or provided by a person other than the deceased and such other person is not acting in concert or by arrangement with the deceased, no tax will be exigible. In the case of Re Gasston (discussed supra) the insurance proceeds escaped taxation because of such a state of affairs.

In the earlier case of Attorney-General v. Murray, which involved a marriage settlement, the Court of Appeal concluded that no

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18 [1944] 1 D.L.R. 542 at 545.
19 [1901] 2 Ir. R. 67.
tax was payable under the terms of s. 2(1)(d) of the U.K. Finance Act on the basis of the same principle. The facts in this case were that a father settled a fully-paid insurance policy in trust for his son's wife for life at the time of the marriage of the son. On the death of the son (his father having predeceased him) estate tax was claimed on the insurance proceeds under the terms of section 2(1)(d). The Court dismissed the claim because, although the son had known and approved of the settlement, it could not be shown that he had purchased or provided it, in concert or by arrangement with another. In fact, the person who had purchased or provided it was the father. In this case, however, the policy was void for want of an insurable interest.

Jameson, in his text, *Canadian Estate Tax*, states:

The provision by the decedent must be a provision in fact, although it is not necessary that it should be made direct. It is sufficient if the decedent provides the means and sets the process in motion, but if he was repaid for the payments he made, or where he paid the premiums due to an agreement under which he received full consideration, no duty is payable.

The third condition, noted by Lord Morton, which must be fulfilled before tax is payable under the terms of s. 3(1)(j) of the Estate Tax Act and s. 2(1)(d) of the U.K. Finance Act, 1894, is that "a 'beneficial' interest . . . [in the property] . . . must accrue or arise by survivorship or otherwise on the death of the deceased." The application of this third condition of taxability has given rise to some of the most difficult problems in relation to the interpretation of the concept embodied in these sections. If Jameson is correct in his assertion that the omission of the word 'beneficial' from s. 1(p)(ii) of the Ontario Succession Duty Act is not significant, and the decided cases support this contention, then the following discussion is equally applicable to that section.

The leading case relating to the problem of whether or not a 'beneficial interest' accrues or arises on the death of a person is the House of Lords decision in *D'Avigdor-Goldsmid v. I.R.C.* The facts of the case were that the deceased, on his marriage in 1907, made a settlement in trust into which he brought an insurance policy together with other property and he covenanted with the trustees to pay the premiums on the policy annually. Later, in 1930, the settlement was terminated and the property in it, including the insurance policy, was re-settled on such trusts as the deceased and the plaintiff (who was the deceased's son) should appoint and in default of appointment on certain named trusts. In 1934, the deceased and the plaintiff appointed that the policy, *inter alia*, should be held in trust for the plaintiff absolutely and that the deceased would be released from the payment of any further premiums on the policy. From 1934 until the deceased's death in 1940, the plaintiff son paid the premiums on this policy. After the settlor's death, the Crown sought to tax the

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22 *Supra*, footnote 8.
policy under the terms of s. 2(1)(d) of the Finance Act but the House of Lords unanimously dismissed the claim.

In the course of his judgment, Lord Parker stated:23

If it is accurate to say that the interest which is aimed at in s. 2(1)(d) is the policy money when received and not the contract of insurance represented by the policy, there does spring up for the first time on the death of the assured an interest which, then and then only, arises or accrues... But, in my opinion... I cannot accept the view that some fresh interest accrues or arises in the beneficial holder of a policy on the death of the deceased life.

Lord Parker then stated that since the appellant had been the absolute owner for some six years prior to the death, he did not get a new interest in the policy at the time of death, he merely obtained an increase in the value of the interest which he had received prior to the death.

Lord Asquith of Bishopstone stated in his judgment in the same case:

The 'beneficial interest' referred to in the concluding lines of the material paragraph was a 'beneficial interest' in the 'other interest' referred to in its opening lines. It is a clumsy collocation of terms, no doubt, but it must mean a beneficial interest in a contractual right to exact £X if and when Sir Osmund (the father) should die... The death has not generated a new beneficial interest. What it has done is to enhance the value of the 'other interest' in which the beneficial interest subsisted.24

In short, no tax was exigible under s. 2(1)(d) in this case because the son received no new interest in the policy. He had merely obtained "the fruition of the (absolute) interest he already held, the quality of the right remained unaltered"; and the death was merely the time at which the right was realized.

In the later case of Re Barbour's Life Assurance Policies: Wrightson et al v. I.R.C.,25 the House of Lords applied the principles it had enunciated in the D'Avigdor-Goldsmid case. The facts in this case were that the deceased settlor had irrevocably settled fully-paid insurance policies on his own life in trust for certain beneficiaries for life in 1932 and the settlor died some eighteen years later. The Crown had claimed estate tax under s. 2(1)(d) but their Lordships dismissed the claim. The House of Lords held that the interest of beneficiaries in such settled life policies was an interest in possession effective from the date of settlement, and the right to receive the income from the proceeds of the policies after the death of the settlor is not a new right accruing to them by the event of death.26

However, Jameson notes in his text, Canadian Estate Tax, that the effect of these two decisions is merely to exclude insurance from tax under these sections in instances where the beneficiary had

24 [1953] 1 All E.R. 403 at 417.
acquired an absolute and indefeasible right to the interest which was purchased or provided by the decedent. If the interest was defeasible and became indefeasible on the death, then there is a change of interest and the section [3(1) (j) of the Estate Tax Act] will apply. Similarly, if there is a change of interest in respect of an interest contingent on the beneficiary surviving the decedent.27

The author cites, inter alia, the case of Adamson v. Attorney-General28 as an authority for this statement. The case is well worth noting since it led to an immediate revision of the statutory provisions in the U.K. Finance Act.

The facts of the case were that the settlor established a trust wherein he directed that the trustees apply the capital of the trust fund for the benefit of his children living at the date of the trust or any children born thereafter, as he should appoint. The trust further provided that any income not so appointed should be applied by the trustees during the settlor's life for the benefit of such children as he should appoint. Any excess income was to be added to capital. On his death, the income and capital not then distributed were to be paid to his children as he should by deed or will appoint and there were further provisions to take effect if no appointment was made. The settlor died without making any appointment and leaving three children who had been living at the date of the creation of the trust.

Their Lordships held that the provisions of section 2(1)(d) applied because on the settlor's death, the children became entitled to a share in the fund to which, before the settlor's death, they had only held a beneficial interest in expectancy. The change of interest was held to have arisen on death and to have been provided by the deceased.

However, the Court further held (Lord Russell dissenting) that the property was taxable only to the extent to which the principal value of such beneficial interest upon the death of the settlor exceeded the actual value of the expectancy beneficial interest of each child before the death of the settlor. This second conclusion was based on the fact that the section only imposed tax "to the extent of the beneficial interest therein arising or accruing on the death of the deceased". The result of course would be to render the tax exigible on a small portion of the property involved rather than on the whole capital value of the trust at the time of death.

The defect in the legislation being thus made obvious, Parliament reacted quickly and enacted s. 28 of the Finance Act of 1934. This section had the effect of providing that the extent of any beneficial interest accruing or arising on the death of the deceased and falling within section 2(1)(d)

... shall be ascertained, and shall be deemed always to have been ascertainable, without regard to any interest in expectancy the beneficiary may have had therein before the death.29

29 The terms of s. 3(4a) of the Estate Tax Act which section was enacted in 1962 are substantially the same as s. 28. See discussion infra.
In the case of *Re Parkes' Settlement Trusts Midland Bank et al v. I.R.C.*, the English Court of Appeal indicated that the beneficial interest arising or accruing on the death of the person who purchased or provided the property would not always be subject to tax under the terms of section 2(1)(d).

Here, the deceased had established an inter vivos trust, the terms of which provided, *inter alia*, that each of his two daughters was entitled to the income of the trust until the settlor's death up to the amount of £250 or half the income whichever was the lesser sum. On his death, the daughters were to become entitled to an annuity of £250 out of trust income or the capital, if necessary. Further, each of the settlor's four children was entitled to the surplus income during the settlor's life and each was, contingently on surviving him, entitled to share the trust capital equally with the others, subject to the annuities granted to the daughters. The settlor died and each of the four children survived him.

The Court of Appeal indicated that the corpus of the trust was taxable as a beneficial interest arising or accruing on death since such interest clearly vested on the settlor's death within the terms of section 2(1)(d). However, the Court held that the annuities to the daughters were not taxable on the basis that there was no change in the beneficial interest before and after death to justify tax being exigible.

Lord Evershed, M.R., explained this aspect of the Court's decision, thus:

... There was, of course, this difference in the incidents of that right during the settlor's life and after his death. During the former period, the yearly sum was payable exclusively out of the income of each year and was supported by no charge on capital and by no continuing charge on income. After the settlor's death, the yearly sum was charged on the corpus of the fund specially appropriated for the purpose; but in point of beneficial enjoyment there was no essential difference in my judgment, before and after the settlor's death...31

It is submitted, with all due respect to the learned judge, that this line of reasoning is, in some respects, faulty. Although there was no change in the "beneficial enjoyment" of the interest in the property, there is a great difference in the "beneficial interest" held by each daughter prior to and after the death of the settlor. The terms of the section are designed to tax the difference in the rights of the beneficiary in relation to the property and not the difference in the enjoyment of the property.32

If the property, which was the subject of the trust in this case, had produced no income whatsoever before the settlor's death, then the "beneficial enjoyment" would be taxable, if one applies the same

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30 [1956] 1 All E.R. 833.
31 Id. at 837.
32 See the judgment of Lord Asquith in the *D'Avigdor-Goldsmid* case (discussed supra).
reasoning as did Lord Evershed in this case. This, it is submitted, was not the intention of the legislature nor can it be supported by the plain meaning of the words in the section.

The most recent British case of importance in relation to the problem of determining what is a “beneficial interest accruing or arising on death” is the decision of the House of Lords in Parker et al v. Lord Advocate (on behalf of Inland Revenue Commissioners).33 The facts of the case were that, in 1938, the settlor established a trust fund under which, during the lifetime of the settlor, the income was to be paid to her three children and upon the settlor's death the trust fund was to be divided into three equal shares and a share was to be paid over to each of the children as an absolute share. Under the applicable Scottish law, the children had no interest in the trust fund itself until the settlor's death, at which time each child became entitled to one-third of the capital in the fund. The settlor died in 1956 and the Crown claimed tax on the whole of the fund under the terms of s. 2(1)(d) as extended by s. 28 of the Finance Act of 1934.34

The Court held that, since the right to income ended at the death of the settlor and since the capital of the trust fund became absolutely vested in the beneficiaries at the same time, the beneficial interest that arose or accrued at the time of death extended to the principal value of the capital of the trust fund at that time. In deciding the case, their Lordships quoted with approval parts of the decision of the Court of Appeal in the earlier case of Re Parkes' Settlement Trusts discussed supra.

The effect of the Parker decision would seem to be that if there is any change in the interest held by the beneficiaries of an inter vivos trust fund at the time of the death of the settlor, then the new interest which is created at that time will be taxable without regard to any previous rights held by the beneficiaries in such fund, if, in fact, such rights as existed prior to the death of the settlor ceased at that time.

The D'Avigdor-Goldsmid case is distinguishable because in the D'Avigdor case, the beneficiary had absolute control over the policy to the extent that no further interest could be attached to it. In the Parker case the beneficiaries, while they had an absolute right to the income prior to the death, had no control over the capital of the trust fund as a present interest until the time of death of the settlor. In essence, the beneficiary in the D'Avigdor case could deal with the policy as a present interest before the settlor's death, whereas the beneficiaries in the Parker case could only deal with the capital of the trust fund as an interest in expectancy until the time of the settlor's death.

As was noted earlier in this study, s. 3(4a) of the Estate Tax Act, modelled upon s. 28 of the U.K. Finance Act, 1934, was enacted

34 Supra, footnote 2.
35 [1956] 1 All E.R. 833.
in 1962. Shortly before this, the Exchequer Court of Canada per Mr. Justice Kearney gave its decision in the case of the Bassett Estate v. M.N.R.\textsuperscript{36} which, in all likelihood, prompted the passage of s. 3(4a).

The case involved s. 3(1)(g) of the Dominion Succession Duty Act.\textsuperscript{37} Since s. 3(1)(g) is substantially the same as the present s. 3(1)(j) of the Estate Tax Act, the case is worth noting. Briefly, the facts were that, in 1947, the deceased, who was president of a publishing company, accepted an offer from the company of a pension for himself for life, and after his death, an annuity for his wife for life, in lieu of a regular salary. The Court found that the annuity had been provided by the company rather than the deceased and was thus not taxable under s. 3(1)(g). However the Court indicated, \textit{obiter}, that if the annuity had been provided by the deceased, the beneficial interest arising or accruing on the death of the husband would have been the value of the annuity subsequent to the husband's death minus the value of the interest in expectancy prior to his death. It was to prevent such an argument being applied in relation to s. 3(1)(j) of the Estate Tax Act that s. 3(4a) was enacted.

In concluding the analysis of the meaning and application of the sections which presently tax annuities or other interests provided by the deceased to the extent of the beneficial interest accruing or arising on death, it is apparent that the Courts have interpreted both "other interests" and "beneficial interest" very widely so as to give the sections a broad area of application. It is submitted, however, that by doing so, the Courts have robbed the statutory provisions of the quality of preciseness which is essential for any definitive section of a taxing statute. Under the present case law, it is submitted that a "beneficial interest" which is taxable within the context of section 3(i)(j) includes the following:

(1) Any interest in property which comes into being at the death of the person who purchased or provided it, no such interest having existed in any other person previously (as in the case of insurance policies); or

(2) Any interest in property (which property is itself a beneficial interest in property) which changes hands on the death of the person who purchased or provided it (as in the case of a different class of beneficiaries becoming entitled to a right in relation to the corpus of a trust on the death of the deceased who purchased or provided it);\textsuperscript{38} or

(3) Any interest in property held by the beneficiary before the death of the deceased who purchased or provided it, which interest is changed on the death of the person who purchased or provided it directly or indirectly.\textsuperscript{39}

At this point, in order to illustrate some of the difficulties involved in applying s. 3(1)(j) of the Estate Tax Act, it would perhaps

\textsuperscript{36} 62 D.T.C. 1032.
\textsuperscript{37} R.S.C. 1952, c. 89. This Act has since been repealed.
\textsuperscript{39} Parker v. Lord Advocate, [1960] 1 All E.R. 20; but see also the discussion of \textit{Re Parkes' Settlement Trusts} (supra).
be convenient to consider the taxation of insurance proceeds under this section.

At the present time, it is not readily apparent whether or not the words "or other interest" will apply to insurance proceeds in view of the fact that section 3(1)(m) of the Estate Tax Act specifically applies to insurance policies and taxes them on the basis of ownership and control immediately prior to the death of the insured.

W. Ivan Linton, of the Department of National Revenue, stated in _A Review of the Estate Tax Act:_

>...there has been a certain amount of concern that perhaps this Act imports into this section [3(1)(j)] some reference to insurance. We have given this a good deal of thought, but it is our conclusion—at the moment, anyway—that 'other interest' in this section cannot be construed as referring to any ordinary kind of insurance on the deceased's life and this is for two reasons. One is that we now have in this Act very specific provisions for taxing life insurance. They are provisions entirely different from those in the corresponding British legislation, different not only in wording but also in principle; and we do not think that even if we wanted to we could use the words 'other interest' in (j) as imposing a tax in conflict with the tax on insurance in 3(1)(m).

However, in a recent article in the Canadian Tax Journal, Messrs. McIntosh and Patterson noted in reference to this problem that there is, in their view, strong reason to suppose that s. 3(1)(j) could be used to tax insurance policies.

The argument against it (i.e. the fact that s. 3(1)(j) will tax insurance) is that where there is a specific section of a statute which, so to speak, competes with a general section, the specific section governs. However, in our view, there is no competition between (j) and (m). Subsection (m) catches certain types of life insurance, subsection (j) catches others.

It is submitted that this latter view is correct.

In support of this submission, the following example is offered for consideration. If the insured establishes an irrevocable insurance trust and the trustees apply for the insurance and pay the premiums on the policy from funds provided by the settlor, the following estate tax consequences would ensue. The terms of s. 3(1)(m) would not apply to tax the proceeds at the time of death, since the policy was not owned by the deceased nor was it under his control within the terms of s. 3(5) of the Act, whether or not such proceeds were distributable on death. However, it is submitted that the terms of s. 3(1)(j) would apply to tax the insurance as an "other interest" purchased or provided by the deceased.

The next section of this paper will be devoted to an examination of the ways and means in which annuities and "other interests" can be disposed of free and clear of estate tax and succession duties. In

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41 Don't Give Insurance—Give Money. McIntosh and Patterson. 1964. 10 Can. Tax Jour. at p. 187 et seq.
42 For a fuller discussion of this problem see _The Report of the 1964 Conference_, Canadian Tax Foundation, pp. 267, 282, 283 et seq.
the article *Don't Give Insurance—Give Money*\(^3\) the authors adopted the following scheme to escape death taxes.

In the case where a husband wishes a minor child to receive a death benefit from an insurance policy on the father's life, the following steps could be taken. First, the wife should apply for the policy and name the child as beneficiary. . . . Under the terms of s. 3(1)(m) and s. 3(5) of the Estate Tax Act, the wife would thus be the policy owner. Secondly, the husband could make annual gifts to the wife of cash, which cash the wife is free to dispose of as she sees fit. The authors note that even if the wife uses the cash to pay the premiums on the policy, it could well be argued that it is the wife, and not the husband, who provided the money to buy the "other interest" within the terms of s. 3(1)(j). Further, if the minor child is irrevocably named as beneficiary under the terms of section 157 of Part V (1962) of the Insurance Act, it could be argued that no beneficial interest arose on death, for, by the nature of the irrevocable appointment, the beneficial interest arose at the time of the appointment. If either of these arguments is successful, then, it would appear that the operation of s. 3(1)(j) is precluded. The effect of the above procedure would also effectively preclude the operation of section 1(p)(ii) of the Ontario Succession Duty Act which relies on the premium-payment test.

The gift tax consequences of this scheme must be examined as well. For purposes of this study, it will be assumed that there are no gift tax consequences involved in the annual gifts by the husband to the wife. However, it should be noted that if nothing further is done under the above scheme, the wife could well be assessed for gift tax at the time of the maturity of the policy, on the basis that the amount of the policy is a gift from the mother to the child.

This result can be avoided in two ways. The first method is to have the mother sell the policy to the child when it reaches its majority but this method runs the risk of the insured dying before the child becomes of age.

The second, safer method, is to have the wife convey the policy into a trust for the child during the insured's lifetime and then have the wife pay the premiums through the trust. This would safely prevent gift tax being applicable if the insured should die during the child's minority.

The final problem to be discussed in this article is that relating to the taxation of discretionary trusts under the terms of sections 3(1)(j) and 1(p)(ii) respectively. To illustrate this problem, the following example is offered for consideration:

A settlor establishes an irrevocable inter vivos trust fund made up of interest-bearing securities. The settlor directs, *inter alia*, in the trust deed, that the income of the trust is to accumulate during his

\(^3\) *Supra*, footnote 41.
lifetime and upon his death is to be distributed to named beneficiaries, at the discretion of the trustees.

In this regard it is necessary to determine whether or not any beneficial interest in the trust res accrued or arose on the settlor's death. Although the right to income from a trust is a beneficial interest\textsuperscript{44} in the trust, it would seem that, in the example, the right to income would not arise or accrue on the death of the settlor; in fact, the right to the income will not accrue or arise in the beneficiaries until the trustee's discretion is exercised. Further, it would appear that the right of the beneficiaries to the income from the trust is \textit{not changed} by the fact of the settlor's death. Prior to the death, the beneficiaries would hold an interest in expectancy in relation to the income and after the death, the interest remains an interest in expectancy until the discretion of the trustees is exercised in favour of the beneficiaries. Therefore, one would conclude that the right to income would not be taxable as a beneficial interest in the trust res arising or accruing on the death of the settlor.

However, what about the right of the beneficiaries to ask the trustees to exercise their discretion in relation to the distribution of the income of the trust? Is it subject to death tax under the terms of the sections discussed?

This right was provided by the deceased and would thus be taxable if it is deemed to be an "other interest" within the terms of section 3 (1) (j) of the Estate Tax Act, and section 1 (p) (ii) of the Succession Duty Act respectively. On the basis of the decision of Mr. Justice Dysart in \textit{Re Gasston (supra)}, it would seem that the term "other interest", not being subject to the \textit{ejusdem generis} rule, could apply to any interest in property. The issue then would be to determine whether or not the right of the beneficiaries to ask the trustees to exercise their discretion can be construed to be "property" within the context of the Acts discussed.

In the Estate Tax Act, "property" is defined in section 58 (1) (o) as follows:

\begin{quote}
'property' means property of every description whatever, whether real or personal, movable or immovable, or corporeal or incorporeal and without restricting the generality of the foregoing, includes any estate or interest in any such property, a right of any kind whatever, and a chose in action;
\end{quote}

It would appear that the right to ask the trustee to exercise his discretion in relation to the trust income is a "right of any kind whatever" and thus, one is forced to conclude that a right such as this may well be taxable under the terms of the Estate Tax Act to the extent of the beneficial interest therein arising or accruing on the death of the settlor who provided it. Although the Ontario Succession Duty Act has no parallel provision to s. 58 (1) (o) of the Estate Tax Act,\textsuperscript{44} \textit{A.G. v. Lloyd's Bank} [1935] A.C. 382.

\textsuperscript{44}
it is likely that such a right might also be taxable under the terms of the former statute.

The question which automatically follows from this submission, is how can such a right be evaluated. It is submitted that the beneficiary having such a right could borrow money on the security of it. Surely this right would have some value to a lender, and it would follow that the taxing authorities could base an assessment on this value.

If the valuation of such a right becomes an issue before the courts, the courts might well be required to consider how the trustees intend to exercise their discretion. Generally speaking, the courts will not exercise control over trustees in relation to trustees' discretionary powers. However, they may under certain circumstances require that trustees exercise their discretion in favour of one or more of the beneficiaries, e.g. in a situation where a discretionary trust is established for the maintenance, benefit and education of the beneficiaries, and the beneficiaries are in need of moneys for educational purposes and have not received such moneys from the trustees.

It is thus submitted that a right to ask trustees to exercise their discretionary powers may be taxable as an interest in property arising or accruing on the death of a person who provided such interest within the terms of Section 3 (1) (j) of the Estate Tax Act and section 1 (p) (ii) of the Ontario Succession Duty Act.

Having examined the problems and the application of the provisions in the Canadian statutes which tax annuities and other interests on death, it is submitted, in conclusion, that these provisions could, if time permits, be re-examined by the Royal Commissions which are presently studying tax legislation, both at the Ontario and Federal level with a view to rendering their terms more precise. Any amendments having this effect would be welcomed by every member of the taxpaying public.

46 A. W. Scott, op cit., pp. 1389 et seq. See also Wilson v. Turner (1883), 22 Ch. D. 521.