BETWEEN:

MONTREAL TRUST COMPANY, Executors under the Will of CHESLEY ARTHUR CROSBIE ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Montreal 1966 Sept. 30 Ottawa Oct. 11

Estate tax—Company controlled by deceased—Gift or benefit conferred on blood relative within three years of death—Grant of option to buy shares at less than actual value—Option given for legitimate business reasons—Estate Tax Act, 1958, c 29, s. 3(1)(c) and (g)—"Gift", "partial consideration", meaning of—Estate Tax Act, s. 3(6)(b)—Construction of statute—Intent of Parliament

In November 1961 the directors of a company controlled by CC, granted AC, an employee of the company and a blood relative of CC, in view of his past services and as an incentive for his future services, i.e. wholly for legitimate business reasons, an option to buy 18,500 shares of the company during the years 1961, 1962 and 1963, as long as he remained an employee of the company, at 10¢ a share, their actual value being $4 94 a share. In exercise of the option AC bought 6,167 shares in December 1961, 6,167 shares in March 1962 and 6,166 shares in January 1963. CC died on December 26th 1962 and his estate was assessed to estate tax in respect of the grant of the option or alternatively of the shares issued to AC in December 1961 and March 1962 as being a gift or a disposition of property for partial consideration made within three years prior to CC's death (secs. 3(1)(*c*) and (*g*) of the *Estate Tax Act*).

Held, the estate's appeal must be allowed.

1 A gratuitous payment by an employer to an employee as remuneration for services, past or future, though made without consideration as that word is used in the common law of contracts is nevertheless made for a business reason i e, for a "cause", and such a payment does not fall within the ordinary meaning of the word "gift" as employed in s 3(1)(*c*) of the *Estate Tax Act*.

2 For the like reason a benefit conferred by an employer on an employee by transferring property to him for less than its value is not a disposition "for partial consideration" within the meaning of s. 3(1)(*g*) if it is done as remuneration for services Having regard to the French version of s 3(1)(*g*) wherein the phrase in the English version "for partial consideration" is "pour une cause ou considération partielle", the word "consideration" in the English version is used not in the common law sense as payment supported exclusively by business considerations but as payment partially supported by such motives as love and affection, family duty or philanthropy.

Semble. The grant of an option to AC to buy shares as long as he remained an employee of the company created no contract between

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the company and AC and there was therefore not a disposition of property within the meaning of s. 3 of the *Estate Tax Act* until the option was exercised.

Semble. Section 3(6)(*b*) of the *Estate Tax Act* does not apply to a disposition made by a company controlled by a deceased to a person unless it was made to that person as a "person connected with the deceased by blood relationship, marriage or adoption", and therefore does not apply to a payment *bona fide* made to an employee for services merely because the employee is so connected with the deceased.

APPEAL from assessment under the *Estate Tax Act.*

Maurice A. Regnier and *Stanley H. Hartt* for appellants.

D. G. H. Bowman for respondent.

JACKETT P.:—This is an appeal by the Estate of Chesley Arthur Crosbie of the City of St. John's, Newfoundland, who died on December 26, 1962, from an assessment under the *Estate Tax Act,* chapter 29 of the Statutes of Canada, 1958, as amended. The sole reason for the appeal is the inclusion by the respondent, in the computation of the aggregate net value of property passing on the death of the deceased, of the sum of $109,150 as being the value of a gift deemed to have been made by the deceased within three years prior to his death to Andrew C. Crosbie, or, alternatively, as being the amount of a benefit deemed to have been conferred by the deceased within three years prior to his death upon Andrew C. Crosbie by a disposition of property for partial consideration.

It is common ground that, at all times material to this appeal prior to his death, Newfoundland Engineering and Construction Limited (hereinafter referred to as "the company") was a corporation "controlled" by the deceased within the meaning of the word "controlled" as used in paragraph (*b*) of subsection (6) of section 3 of the *Estate Tax Act.*

On November 30, 1961, the company had an employee, Wallace Pennell, who had been a full-time employee of the company for seven years, and one Andrew C. Crosbie, who had been a director of the company since September, 1958 and secretary-treasurer of the company since June, 1959.

It is common ground that Andrew C. Crosbie, who was paid a salary as secretary-treasurer, was "connected with

the deceased by blood relationship" within the meaning of those words as used in paragraph (*b*) of subsection (6) of section 3 aforesaid, and that Wallace Pennell was not so connected with the deceased. On that day, that is November 30, 1961, the directors of the company adopted two resolutions reading as follows:

The Chairman advised the meeting that in view of the long and faithful service of Mr. Wallace Pennell to the Company and as a further incentive to him to continue to render such service to the Company, Mr. Pennell should be granted an option to purchase eighteen thousand five hundred (18,500) shares without par value of the capital stock of Newfoundland Engineering and Construction Company Limited for the price of ten cents (10¢) per share which option should extend for a period of one month from the date of this meeting. On motion duly made and seconded, Mr. Pennell refraining from voting, it was unanimously resolved that Mr Wallace Pennell, Vice-President and General Manager of the Company, be granted an option effective for one month from the date of this resolution to purchase from the Company eighteen thousand five hundred (18,500) shares without par value of the capital stock of the Company for the price of ten cents (10¢) per share in recognition of his services to the Company.

The Chairman advised the meeting that in view of the valuable and faithful service of Mr Andrew Crosbie to the Company, in view of his present service and the prospect of his continued valuable service to the Company and as a further incentive to him to continue to render such service to the Company, Mr. Crosbie should be granted an option to purchase eighteen thousand five hundred (18,500) shares without par value of the capital stock of the Company for the price of ten cents (10¢) per share, which option should only be exercisable by him as long as he remains an employee of the Company and which option should be exercisable by him during the year 1961 for sixty-one hundred and sixty-seven (6167) shares, exercisable by him during the year 1962 for sixty-one hundred and sixty-seven (6167) shares and exercisable by him during the year 1963 for sixty-one hundred and sixty-six (6166) shares of the Company Upon motion duly made and seconded, Mr. Andrew Crosbie refraining from voting, it was resolved that Mr. Andrew Crosbie, Secretary-Treasurer of the Company, be granted an option effective only so long as he continues to be an employee of the Company to purchase from the Company during the year 1961 sixty-one hundred and sixty-seven (6167) shares without par value of the capital stock of the Company for the price of ten cents (10¢) per share, during the year 1962 sixty-one hundred and sixty-seven (6167) shares without par value of the capital stock of the company for the price of ten cents (10¢) per share, and during the year 1963 sixty-one hundred and sixty-six (6166) shares without par value of the capital stock of the Company for the price of ten cents (10¢) per share in recognition of his past and present service to the Company.

In December 1961, Pennell exercised the "option" so granted to him and 18,500 fully paid shares were issued to him by the company upon payment by him to the company of ten cents per share.

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In December 1961, and March 1962, respectively, Andrew C. Crosbie exercised the "option" so granted to him in respect of 6,167 shares on each occasion, and, on each occasion, 6,167 fully paid shares were issued to him by the company upon payment by him to the company of ten cents per share.

As already indicated, the deceased died on December 26, 1962.

In January 1963, Andrew C. Crosbie again exercised the "option" that had been granted to him by the company in November 1961, and 6,166 shares were issued to him by the company upon payment by him to the company of ten cents per share.

At all times material to this appeal, the shares so issued to Pennell and Andrew C. Crosbie had a fair market value of $4 94 per share.

The parties to the appeal have expressly agreed that the aforesaid "options" were "granted" for "legitimate business reasons".

The parties have also agreed, although it is probably not relevant to the determination of this appeal, that Pennell and Andrew C. Crosbie paid income tax under section 85A of the *Income Tax Act* on the benefits that accrued to them from the exercise of the aforesaid options, which income tax was not payable unless the benefit was received "in respect of, in the course of or by virtue of the employment" as employees of the company. (See subsection (7) of section 85A.)

It is common ground that the assumption as to the value of the shares upon which the Minister based the assessment appealed against was excessive and that, assuming that the appellants are otherwise unsuccessful, the appeal is to be allowed with costs to the respondent and the assessment is to be referred back to the Minister for reassessment on the basis that the aggregate net value of property passing on the death of the deceased be reduced by $19,600 from the amount upon which the assessment was based.

The relevant provisions in the *Estate Tax Act* read as follows:

3 (1) 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,

. . .

(*c*) property disposed of by the deceased under a disposition operating or purporting to operate as an immediate gift *inter vivos*, whether by transfer, delivery, declaration of trust or otherwise, made within three years prior to his death;

. . .

(*g*) property disposed of by the deceased under any disposition made within three years prior to his death for partial consideration in money or money's worth paid or agreed to be paid to him, to the extent that the value of such property as of the date of such disposition exceeds the amount of the consideration so paid or agreed to be paid;

(6) For the purpose of this Act,

(*b*) a disposition made by a corporation controlled by the deceased to or for the benefit of any person connected with the deceased by blood relationship, marriage or adoption shall be deemed to be a disposition made by the deceased to or for the benefit of that person, and, in relation to any such disposition, any act or thing done or effected by that corporation shall be deemed to have been done or effected in all respects as though that corporation were the deceased;

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4 (1) Notwithstanding section 3, there shall not be included in computing the aggregate net value of the property passing on the death of a person the value of any such property acquired pursuant to a *bona fide* purchase made from the deceased for a consideration in money or money's worth paid or agreed to be paid to the deceased for his own use or benefit, unless such purchase was made otherwise than for full consideration in money or money's worth paid or agreed to be paid as hereinbefore described, in which case there shall be included in computing the aggregate net value of the property passing on the death of the deceased in respect of the property so acquired only the amount by which the value of the property so acquired computed as of the date of its acquisition exceeds the amount of the consideration actually so paid or agreed to be paid.

58. (1) In this Act,

. . .

(*e*) "disposition" includes any arrangement or ordering in the nature of a disposition, whether by one transaction or a number of transactions, effected for the purpose or in any other manner whatever;

As I appreciate the position of the parties to this appeal, there is no dispute as to the basic facts although there may be some question as to what inferences should be drawn from them. Nothing, therefore, turns on an onus of proof. What has to be decided is a question of law as to whether the assessment can be supported in whole or in part by the provisions of the taxing statute.

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The respondent's position as to that, as I understand it, may be stated as follows:

(1) In the first place, he says that the grant of the "option" by the company to Andrew C. Crosbie in November, 1961, was a "disposition" made by a "corporation controlled by the deceased" to a "person connected with the deceased by blood relationship" and must therefore be "deemed" by virtue of section 3(6)(*b*) to be "a disposition made by the deceased to...that person"; and, that being so, the option is "property disposed of by the deceased" under a "disposition operating...as an immediate gift *inter vivos* . . . made within three years prior to his death" and so must be included in computing the aggregate net value of the property passing on his death by virtue of section 3(1)(*c*).

(2) Alternatively, he says that, if the grant of the "option" was not such a disposition, the issue of the shares by the company to Andrew C. Crosbie in December, 1961, and March, 1962, was a "disposition" made by "a corporation controlled by the deceased" to "a person connected with the deceased by blood relationship" and must therefore be "deemed", by virtue of section 3(6)(*b*), to be "a disposition made by the deceased to...that person"; and, that being so, the shares are "property disposed of by the deceased" under a "disposition made within three years prior to his death for partial consideration in money or money's worth paid or agreed to be paid to him" and so must be included in computing the aggregate net value of the property passing on his death, by virtue of section 3(1)(*g*), "to the extent that the value of such property as of the date of such disposition exceeds the amount of the consideration so paid or agreed to be paid".

There are at least two submissions made by the appellant against the respondent's position upon which I do not propose to express any opinion and which, therefore, I will merely endeavour to indicate at this point. The first of these is that the *creation* of a right or property falls outside the word "disposition" and therefore neither the grant of an option nor the issue by a company of shares can be regarded as a disposition of property. The second is that,

even if the issue of the shares can be regarded as a disposition by the company of shares to Andrew C. Crosbie for a partial consideration, the partial consideration cannot be regarded as having been "paid to him" ("him" being the deceased) within section 3(1)(*g*) inasmuch as the concluding words of section 3(6)(*b*) expressly deem any act or thing *done or effected by the company* to have been done or effected as though the company were the deceased (but does not contain any provision which deems anything paid *to* the company to have been paid to the deceased).

Another position taken by the appellant upon which I do not have to express any concluded opinion, having regard to the grounds upon which I have decided to dispose of the appeal, is that the so-called grant of an "option" was no disposition of property because it created no legal right in Andrew C. Crosbie, being no more than an offer to Crosbie to issue shares to him on certain terms. The respondent took the position that there was an implied contract—implied in the sense that it was not expressed—whereby, in consideration of Crosbie continuing to work after the resolution was passed in November, 1961, the company bound itself to issue the shares in accordance with the terms of the resolution if Crosbie elected to exercise the option. If I had to decide this question upon the view I have so far been able to form of the matter, I should have to find that there is no basis for inferring any such contract and that there was therefore no disposition or creation of any rights on property until such time as the option was exercised.

I come to the view of the matter upon which, in my view, the appeal should be decided.

The question that has to be decided is whether a benefit conferred by a company controlled by the deceased, upon Andrew C. Crosbie as an employee of the company "for legitimate business reasons" is to be dealt with for estate tax purposes as property passing on the death of the deceased by reason of the fact that Andrew C. Crosbie happened to be a blood relation of the deceased. There is no suggestion that the transaction was a mere subterfuge for conferring a benefit on Andrew C. Crosbie as a blood relation of the deceased and there is no suggestion that any part of the amount of the benefit is for anything other than the benefit that "legitimate business reasons" dictated that it was in the commercial interest of the company that it

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should confer on this employee. This aspect of the case is underlined by the otherwise irrelevant fact that a similar arrangement was made for a fellow employee on very similar terms at the same time.

One further point needs to be developed in considering the neat point that has to be decided on this appeal. In my view, what was done here falls into a not uncommon category of business transactions, namely, payments made in the ordinary course of business without legal liability. A business is operated to make a profit. No disbursement is a proper business disbursement unless it is made directly or indirectly to attain that end. Generally speaking, business payments are made pursuant to contracts whereby the business man receives a *quid pro quo* for that payment—e.g., contracts for services, purchase contracts, construction contracts, etc. Nevertheless, good business can dictate, depending on the circumstances, disbursements over and above the amounts legally owing for what the business man has received or is to receive. A special payment to a good contractor in unforeseen difficulties so that he will be available for future work, is one example. Bonuses to employees over and above any requirement of the contracts of employment, so as to maintain their goodwill and keep employee morale high is another. Still another is the very type of benefit conferred on senior executives that we find in this appeal. That it is a very common type of benefit conferred on senior executives is evidenced by the special provision made in section 85A of the *Income Tax Act* for their income tax treatment.

Two aspects of the facts call for special attention when it is claimed that the benefit should be treated as part of the deceased's estate for estate tax purposes, viz.:

(*a*) the benefit was conferred on Andrew C. Crosbie as an employee of the company and not as a blood relation of the deceased, and

(*b*) while the benefit was completely gratuitous in the sense that it was not conferred pursuant to a legal obligation as payment for something already received or pursuant to a contract for something to be received, it was nevertheless an ordinary business transaction and had none of the characteristics of what is commonly thought of as a gift *inter vivos*.

Counsel for the respondent submits that neither of these aspects of the matter is of any significance. He would say, I believe, that the statute necessarily contains arbitrary provisions designed to bring into the tax net transactions that might otherwise be employed to avoid the incidence of estate tax and that such provisions are to be applied quite literally to transactions that are not avoidance transactions—probably because of the difficulty involved in establishing that any particular transaction has a tax avoidance character.

I accept the proposition that provisions such as section 3(1)(*c*) and (*g*) and 3(6)(*b*), by their very nature, must be applied according to their terms, regardless of whether their application to particular circumstances may go further than, in the opinion of the Court, is required to carry out the scheme of the statute. I am of opinion, however, that in determining the effect of such a provision, as in the case of determining the effect of any other provision in a statute, it must be weighed having regard to the place it occupies in the scheme of the statute.

Three further questions arise, viz:

(*a*) whether section 3(6)(*b*) applies to a payment by a company controlled by the deceased to an employee in respect of past and future services if that employee happens to be a blood relative of the deceased, and

(*b*) whether a payment made gratuitously by an employer to an employee is a disposition operating or purporting to operate as a "gift" within section 3(1)(*c*) even though such payment was remuneration for services and was motivated exclusively by legitimate business reasons, and

(*c*) whether a transaction whereby a deceased conferred a benefit on an employee by conferring property rights on him for a nominal payment is a disposition "for partial consideration in money or money's worth" within section 3(1)(*g*) even though the benefit is conferred as remuneration for services and was motivated exclusively by legitimate business reasons.

As far as I know there is no authority to guide the Court in deciding any of these questions.

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In view of my conclusion with reference to the second and third of these questions, it is unnecessary for me to reach a concluded opinion with regard to the interpretation of section 3(6)(*b*). Having said that, I may say that I am inclined to the view that that paragraph does not apply to a disposition made by the controlled corporation to a person unless it was made to that person as a "person connected with the deceased by blood relationship, marriage or adoption", and that it does not therefore apply to a payment made by the company to an employee for services merely because that employee happened to be so connected with the deceased. This is not to say that a payment or benefit would not fall within that provision if the employer-employee relationship between the controlled company and the blood relation were being used as a means of making to the blood relation a gift consisting in whole or in part of the amount of the payment or benefit.

The questions that I have formulated with regard to paragraphs (*c*) and (*g*) of section 3(1) may, in my view, be discussed together. The respondent's position, as I understood it, was that there is a gift within paragraph (*c*) if there is no "consideration" in the sense of the consideration required as a condition to the validity of a contract made otherwise than under seal at common law regardless of whether the disposition was made in the ordinary course of business. Similarly, the respondent's position was that a disposition was made for "partial consideration" within paragraph (*g*) if, on the evidence, the value of the "consideration" in the aforesaid sense was less than the value of the property disposed of even if the disposition was the subject of an arm's length contract. I am of opinion that these paragraphs must be read as companion provisions. If a gratuitous (i.e., unenforceable) payment by a business man to an employee as remuneration for services is a "gift" within the meaning of that word in paragraph (*c*), then a transaction whereby a business man, in lieu of simply making such a payment, confers a benefit on an employee by charging him a nominal price for shares is, for the purposes of paragraph (*g*), a disposition "for partial consideration". Conversely, if a gratuitous payment by a business man to an employee as remuneration for services is not a "gift" within the meaning of that word in paragraph (*c*), then a transaction whereby a business man, in lieu of simply mak-

ing such a payment, confers a benefit on an employee by charging him a nominal price for shares is not, for the purposes of paragraph (*g*), a disposition "for partial consideration".

It is beyond controversy that gratuitous payments to employees having regard to their services, past and future, are nevertheless, for business and income tax purposes, payments as remuneration for services; and are taxable in the hands of the employee and are deductible in computing the employer's profit from his business. While such payments may fall within the concept of a "gift" for the purposes of certain principles of common law—e.g., that a contract to make a gift is unenforceable—with much hesitation, I have reached the conclusion that they are not gifts within the meaning of the word "gift" as used in section 3(1)(*c*) of the *Estate Tax Act*.

While there is no "consideration" for such a gratuitous payment in the sense in which the word "consideration" is used by the common law of contracts, there is, from the point of view of the employer, a business reason—that is a "cause"—for making the payment. Having regard to the scheme of section 3, I cannot conclude that Parliament intended, by paragraph (*c*) of section 3(1), to bring within the concept of "property ... passing on the death" of the deceased all payments made by the deceased in the ordinary course of business during the three years prior to his death that did not happen to have been made pursuant to legally enforceable obligations. Such payments are not, in my view, "gifts" within the ordinary use of that word and are not, therefore, gifts within section 3(1)(*c*) of the *Estate Tax Act*. Compare *Finch v. Commissioner of Stamp Duties*[1].

I am reinforced in my view of section 3(1)(*c*) when I come to consider section 3(1)(*g*). Section 3(1)(*g*) applies to dispositions made "for partial consideration". While my first reaction was that this was an adoption by Parliament of the common law concept of "consideration", I find on referring to the French version that the corresponding phrase is "pour une cause ou considération partielle" which, to me, indicates that what we are talking about is a payment that is not supported exclusively by business considerations but is partially supported by such motives as love

[1] [1929] A.C. 427.

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and affection, family duty or philanthropy. Compare *Attorney-General v. Boden*[1], *Attorney-General v. Earl of Sandwich*[2], *In re Baroness Bateman*[3] and *Gorkin et al. v. Minister of National Revenue*[4].

For the above reasons, the appeal is allowed with costs to the appellant and the assessment is referred back to the respondent for reassessment on the basis that the aggregate net value of property passing on the death of the deceased is $109,150 less than that on which the assessment appealed from was based.

I should add that, while the issues upon which I have decided the appeal as I have formulated them differ somewhat from the issues formulated in the "Agreed Statement of Facts" that was filed as Exhibit 1, the issues as I have formulated them were accepted by counsel for both parties as having been raised by the appeal and submissions were made on both sides with regard thereto.

[1] [1912] 1 K.B. 539
[2] [1922] 2 K.B. 500
[3] [1925] 2 K B 429
[4] [1962] S C R 363