Ottawa
1968
Dec. 4-5
Dec. 16

BETWEEN:

GEORGE EDWIN BEAMENT, MAURICE HAMILTON FYFE, ROBERT BARCLAY HUTTON and CANADA PERMANENT TRUST COMPANY, Executors and Trustees of the Estate of Arthur Warwick Beament, deceased. APPELLANTS;

AND

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

Estate tax—Valuation of shares—Contractual obligation on decedent's estate to wind-up company—Company's charter providing for distribution of surplus on winding-up—Reduction in value of shares—Whether obligation affects valuation for estate tax purposes—"Debts", "Encumbrances", meaning—Estate Tax Act, 1958, c. 29, s. 5(1).

In 1961 an investment company was incorporated at decedent's instance with class A and class B shares of $1 00 par value and equal voting rights. The class A shares provided for a 5% preferential dividend and the class B shares provided for dividends exclusively from earnings. The company's charter provided for distribution of surplus assets to class A shareholders on a winding-up. When the company was incorporated decedent and his two sons executed an agreement pursuant to which each son took up 12 class A shares, decedent took up 2,000 class B shares and by his will directed that the company should be wound-up on his death. On decedent's death in 1966 the company was wound-up as provided by his will and its surplus assets (which included capital profits of approximately $144,000) were paid to the class A shareholders. The executors of decedent's estate valued his class B shares for estate tax purposes at $10,725, which was the amount of the company's undeclared income on hand at decedent's death, but the Minister added thereto the amount of the capital profits. Subsequently he reduced his valuation of the class B shares to $110,000.

Held, dismissing the estate's appeal, having regard to the scheme of the *Estate Tax Act* for computing the value of property passing on death, in determining the fair market value of the class B shares no deduction could be permitted for the contractual obligation of decedent and his estate to wind-up the company which would result in the class B shares being converted to $10,725 cash. The estate had thus failed to show that the class B shares as the subject of a hypothetical sale were worth less than $110,000. *C.I.R. v. Crossman et al* [1937] A.C. 26, distinguished.

ESTATE TAX APPEAL.

M. H. Fyfe, Q.C. for appellants.

M. A. Mogan and *J. M. Halley* for respondent.

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

JACKETT P.:—This is an appeal by the estate of Arthur Warwick Beament from the assessment under the *Estate Tax Act* in respect of that estate.

There were two matters in respect of which the notice of appeal was filed, but the second matter was the subject matter of "Partial Minutes of Settlement" dated May 16, 1968, and filed in the court on May 29, 1968. In consequence I decided, at the opening of the trial, that there would be in the pronouncement of judgment a direction that the assessment under appeal be referred back to the respondent for re-assessment in accordance with such "Partial Minutes of Settlement" and that the appellant be entitled to be paid, in respect of such part of the appeal, costs in the sum of $100.

The only question remaining to be decided by the court is the question referred to in the notice of appeal as the "First Matter in Appeal". This is described in the notice of appeal as an appeal in respect of

> The increase by the Respondent of the value of 2000 Class B shares of the par value of $1.00 each in the capital stock of Lakroc Investments Limited by $144,239.14 from the value of $10,725.98 declared by the Appellants in their ET60 Return dated August 5, 1966.

By the reply to the notice of appeal as amended by order of the court dated October 2, 1968, the respondent took the position "that the fair market value of the said 2,000 Class B shares on May 24, 1966, was an amount not less than $110,000", and, during argument, counsel for the respondent made it clear that, while in making the assessment the respondent had assumed that on May 24, 1966 the value of the shares in question was $154,956.12, if the appellant is otherwise unsuccessful in attacking the basis of the assessment, the respondent consents to the assessment being referred back for re-assessment on the basis that the shares in question had a fair market value on May 24, 1966, of $110,000.

Lakroc Investments Limited was incorporated on March 15, 1961, with two classes of shares called Class "A" shares and Class "B" shares, respectively, each class having a par value of $1 per share and voting rights of one vote per share. Class "A" shares carried a right to a preferential dividend of 5 per cent per annum, and Class "B" carried a right to

"all the net earnings of the company arising from income received by it declared as dividends". There was an express prohibition, however, against payment of dividends "out of profits or gains from the sale of investments or other capital assets of the company". Finally, the company's charter provided that, upon winding up, after payment of the dividends expressly provided for the two classes of shares and after repayment of the amounts subscribed in respect of the shares, "the balance of the assets of the company shall be divided *pro rata* among the holders of the Class 'A' shares". The general scheme can be described in general terms as one under which, while the company remained in business, the holders of Class "A" shares received 5 per cent per annum on their subscriptions, if so much were earned, and the Class "B" shareholders received all the rest of the company's current earnings; and, on winding up, the holders of Class "B" shares received only the amounts subscribed for their shares and the Class "A" shareholders received all of what was left including any capital gains that were acquired by the company during its existence and were available for distribution.

On the day that the company was incorporated, the deceased, Arthur Warwick Beament, entered into an agreement with his two children. As this agreement is important, I shall quote the whole of it. In it the deceased is referred to as "the controlling shareholder", one child is referred to as "John", and the other is referred to as "Pat". The agreement reads as follows:

> WHEREAS the Controlling Shareholder is the father of John and of Pat and has informed them of his intention to incorporate a company under the provisions of The Companies Act of Canada with the name of Lakroc Investments Limited, or such other name as the Secretary of State of Canada may permit (herein called "the Company"), with an authorized capital of $50,000.00 divided into 5,000 Class "A" shares of the par value of $1.00 each and 45,000 Class "B" shares of the par value of $1 00 each;
>
> AND WHEREAS the Letters Patent incorporating the Company will provide in effect, in part, as follows:
>
> (*a*) The Class "A" shares will carry a fixed cumulative annual dividend of 5¢ a share but will not otherwise be entitled to any dividends;
>
> (*b*) The Class "B" shares shall be entitled to receive as dividends when declared all the other earnings or income of the Company; provided, however, that no dividends shall be paid out of profits or gains arising from the sale of investments or other capital assets of the Company;

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

Jackett P.

(c) On the dissolution or winding up of the Company or the liquidation of its business or assets or on any division of capital amongst its shareholders, and after the payment of any dividends due to the Class "A" shareholders and the payment to the Class "B" shareholders of any accumulated net earnings as defined above and the par value of the said Class "B" shares outstanding, the balance of the assets of the Company shall be divided pro rata among the holders of the Class "A" shares;

AND WHEREAS the Controlling Shareholder has represented that he will subscribe and pay for 1,997 Class "B" shares of the Company, which with the three incorporators' shares will result in 2,000 of the said Class "B" shares being outstanding;

AND WHEREAS the Controlling Shareholder has requested John and Pat each to subscribe and pay for 12 Class "A" shares of the capital stock of the Company at $1 00 a share and the said John and Pat have agreed so to do upon the representation of the Controlling Shareholder that he will make adequate provision in his Will for the distribution of the assets of the Company amongst its shareholders and the surrender of its Letters Patent as soon as conveniently may be after his death;

NOW THEREFORE in consideration of the premises, the parties hereto agree each with the other as follows:

1. John and Pat each covenant and agree that upon the incorporation of the Company they will subscribe and pay for 12 Class "A" shares of the capital stock of the Company at the price or sum of $1 00 each.

2. The Controlling Shareholder covenants and agrees that upon the incorporation of the Company he will subscribe and pay for 1,997 Class "B" shares of the capital stock of the Company of the par value of $1 00 each at par, and will pay such sum as is necessary to make the incorporators' shares fully paid

3. The Controlling Shareholder covenants and agrees that he will provide in his Will and maintain therein a direction to his executors to take all necessary steps as soon as conveniently may be after his death to cause the debts of the Company to be paid, its assets to be distributed rateably amongst the shareholders of the Company in accordance with the provisions of the Letters Patent incorporating the Company and to surrender the Letters Patent of the Company. The word "Will" as herein used includes any codicil or other testamentary document effective on the death of the Controlling Shareholder, by whatever name it may be called, and the words "Letters Patent" include any Supplementary Letters Patent.

4 Nothing herein contained shall be construed to prevent the Controlling Shareholder during his lifetime exercising his control of the Company to distribute its assets rateably amongst its shareholders in accordance with the said Letters Patent and to surrender the said Letters Patent.

In effect, the agreement provides for the deceased acquiring 2,000 Class "B" shares and for Pat and John acquiring 12 Class "A" shares each, upon the representation of the deceased "that he will make adequate provision in his will for

the distribution of the assets of the company amongst its shareholders and the surrender of its letters patent as soon as conveniently may be after his death".

The deceased, Pat and John did acquire shares as contemplated by that agreement, the company borrowed substantial sums of money and invested its capital so acquired in securities[1] from which, by the time of the death of the deceased, i.e. on May 24, 1966, it had realized a capital surplus of $99,729.09 and an unrealized accretion to the value of securities in the sum of $44,510.05, as well as earnings from securities which were paid out to its shareholders by way of the preferred dividends to the Class "A" shareholders—i.e. Pat and John—and ordinary dividends to the Class "B" shareholder—i.e. the deceased.

The deceased's will, at the time of his death, contained a clause reading as follows:

> 15. I DIRECT my Trustees, as soon as conveniently possible after my death, to do all things necessary to cause Lakroc Investments Limited to pay its debts, to distribute its assets amongst its shareholders and to surrender its charter.

After the death of the deceased, the company was wound up and the holders of the Class "B" shares received, in addition to repayment of loans made by the deceased to the company, repayment of the money subscribed for the Class "B" shares, while Pat and John received the balance of the assets in the sum of $152,963.40[2].

It is common ground that all that I have to decide is what amount should have been included in "aggregate taxable value" of property passing on the death of the deceased in respect of the 2,000 Class "B" shares (cf. section 2(1) of the *Estate Tax Act*), and it is also common ground that this question must be resolved in accordance with the statutory definition of "value" contained in section 58(1), which definition reads as follows:

> (s) "value",
>
> (i) in relation to any income right, annuity, term of years, life or other similar estate or interest in expectancy,

---

[1] Strictly speaking, much of the "loan" was the price at which the deceased sold securities to the company, which price was payable on demand and was never demanded during the deceased's lifetime.

[2] I assume that the discrepancy between this figure and the earlier figure results from gains arising between the death of the deceased and winding up.

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

Jackett P.

means the fair market value thereof ascertained by such means and in accordance with such rules and standards, including standards as to mortality and interest, as are prescribed by the regulations, and

(ii) in relation to any other property, means the fair market value of such property,

computed in each case as of the date of the death of the deceased in respect of whose death such value is relevant or as of such other date as is specified in this Act, without regard to any increase or decrease in such value after that date for any reason.

One cannot help but be struck in this case by the fact that the deceased caused the company in question to be incorporated, put into it a very large amount of capital (subscribed and loaned), operated it as an investment company that, in a relatively short time, accumulated very substantial capital gains, and so arranged things that, upon his death, those capital gains passed to his children, who do not appear to have participated in the venture except that they subscribed the relatively nominal amount of $12 each. Nevertheless, one must not be misled by this aspect of the matter. No attack has been made on the *bona fide* of the arrangements. No resort has been made by the respondent to any provision designed to deal with tax avoidance schemes where closely related persons are involved. It follows, therefore, as I appreciate the matter, that it must be appraised in the same way as it would be appraised if the Class "A" shares had been taken up by persons who were dealing with the deceased at arm's length and who subscribed very substantial sums for a relatively small annual dividend and a covenant by the deceased that the company would be wound up on his death so that they would then receive any capital gains that had been acquired by the company.

The question is therefore what was the "fair market value" of the 2,000 Class "B" shares "computed . . . as of the date of the death of the deceased?"

In fact, having regard to the contract under which the deceased acquired the shares, once the deceased died, all that his estate could realize out of the 2,000 Class "B" shares was

(a) the undistributed current earnings of the company, and

(b) the $2,000 that had been subscribed for the shares.

If, therefore, as of the time of his death or later, the shares were for sale on terms that they would continue, in some way, to be subject to the obligations assumed by the deceased under the contract, no person using reasonable judgment would have paid more for them than the sum of those two amounts, which is, in effect, the value of the shares as declared by the appellants. If, therefore, the correct approach to the question that has to be decided is that the fair market value is what a hypothetical willing buyer would pay to a hypothetical willing vendor to be put in the same position in relation to the shares as the deceased or his estate was on the date of his death, the appeal must be allowed. I think I may say that, by the end of the argument, that was common ground.

The other view of the matter—that put forward on behalf of the respondent—is, in effect, as I understand it, that the "fair market value" of the shares as of the date of the death of the deceased is what a hypothetical willing purchaser would pay to a hypothetical willing vendor for the shares on the basis that the purchaser would not be in any way subject to the obligations that the deceased had assumed by the contract. If that is the correct view, counsel for the appellant accepts it that he has not discharged the onus of showing that the position taken by the respondent's amended reply to the notice of appeal is wrong and judgment would go, as already indicated, referring the assessment back for re-assessment in accordance therewith.

The appeal therefore turns, as I appreciate it, on the narrow issue as to whether the property in question that passed from the deceased to his estate on his death was

(a) the 2,000 Class "B" shares as held by the deceased under the terms of the contract with his children concerning their acquisition, or

(b) the 2,000 Class "B" shares free from the obligations assumed by the deceased under that contract.

In fact, what passed from the deceased to his estate were the shares subject to the obligations assumed by the contract, and, as so held, they cannot be regarded as having a value to any sensible person of more than $2,000 plus undeclared current earnings. The problem that I have to resolve, as I understand it, is whether I can regard the

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

Jackett P.

"property" that passed from the deceased to his estate as being the "bundle of rights" represented by the shares minus the rights that the deceased gave up by executing the contract, or whether I am bound to regard the "property" that passed as being the "bundle of rights" represented by the shares and to regard the obligations under the contract as being a separate contractual matter between the deceased (or his estate) and his children that did not, in law, cut down the "bundle of rights" represented by the shares that passed from him to his estate.

The problem arises under the *Estate Tax Act,* a new statute enacted for the first time in Canada in 1958. As I view it, a problem under such an Act should be considered, at least in the first instance, by reference only to the words used by Parliament in the Act and without referring to decisions under legislation differently worded enacted in earlier times by other legislatures even though the general scheme of such other legislation is the same. Presumably, the Canadian Parliament chose different language in this modern statute in an endeavour to eliminate problems of interpretation arising under earlier legislative models. It will be time enough after considering the effect of the words in the statute under consideration by themselves to look at decisions under earlier statutes to see if they indicate some intent in the statute under consideration that did not appear from a consideration of the words of the statute by themselves.

I turn, therefore, to the *Estate Tax Act,* chapter 29 of 1958 as amended. The following portions of the Act seem to me to have some relevance to the problem before me.

> 2. (1) An estate tax shall be paid as hereinafter required upon the aggregate taxable value of all property passing on the death, at any time after the coming into force of this Act, of every person domiciled in Canada at the time of his death.
>
> (2) The aggregate taxable value of the property passing on the death of a person is the aggregate net value of that property computed in accordance with Division B minus the deductions permitted by Division C.
>
> * * *
>
> 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;

* * *

(i) property transferred to or acquired by a purchaser or transferee under the terms of an agreement made by the deceased at any time providing for the transfer or acquisition of such property on or after his death, to the extent that the value of such property exceeds the value of the consideration, if any, in money or money's worth paid to the deceased thereunder at any time prior to his death;

* * *

(3) For the purposes of paragraph (*c*) of subsection (1),

(*a*) the artificial creation by a person or with his consent during his lifetime of a debt or other right enforceable against him personally or against property of which he was or might be competent to dispose, or to charge or burden for his own benefit, shall be deemed to be a disposition by that person operating as an immediate gift *inter vivos* made by him at the time of the creation of the debt or right, and, in relation to any such disposition, the expression "property" in this Act includes the benefit conferred by the creation of such debt or right;

* * *

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.

* * *

5. (1) There may be deducted in computing the aggregate net value of the property passing on the death of a person

(*a*) the value of

(i) any debts incurred by the deceased, and

(ii) any encumbrances created by him,

bona fide and for full consideration paid or agreed to be paid to the deceased for his own use or benefit, to the extent that such debts and encumbrances were outstanding immediately prior to his death; and

(*b*) reasonable funeral expenses and surrogate, probate and other like court fees in respect of the death of the deceased (but not including solicitors' charges or the expenses of administering property or executing any trust created by the deceased).

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

Jackett P.

(2) For the purposes of this section, a debt or other obligation of the deceased that was created or imposed by or under the authority of a statute shall, to the extent that such debt or obligation was outstanding immediately prior to his death, be deemed to be a debt incurred by the deceased as described in paragraph (*a*) of subsection (1).

* * *

58. (1) In this Act,

* * *

(*o*) "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;

* * *

(*s*) "value",

(i) in relation to any income right, annuity, term of years, life or other similar estate or interest in expectancy, means the fair market value thereof ascertained by such means and in accordance with such rules and standards, including standards as to mortality and interest, as are prescribed by the regulations, and

(ii) in relation to any other property, means the fair market value of such property,

computed in each case as of the date of the death of the deceased in respect of whose death such value is relevant or as of such other date as is specified in this Act, without regard to any increase or decrease in such value after that date for any reason.

The scheme of the Act, as I read it, is as follows: Section 2 imposes an estate tax on the "aggregate taxable value" of all property passing "on the death", and aggregate taxable value is "aggregate net value" minus certain specified deductions. In computing "aggregate net value"

(a) section 3 requires that there be "included" the "value" of all "property" passing on the death, and

(b) section 5 provides that there may be "deducted" the "value" of

(i) "debts",

(ii) "encumbrances".

Applying this general scheme to a simple case where "property" that passed on death represented all the assets of an estate and "debts", and "encumbrances" represented all the liabilities of the estate, this statutory concept of "aggregate net value" would represent the net worth of the estate at the time of death. It seems clear, moreover, that what is contemplated is that, on the one side, there is to be included the full "value" of all "property" ignoring any debt or en-

cumbrance related to the property, and, on the other hand, there is to be deducted the "value" of all "debts" and "encumbrances" including any related to the "property" the value of which has been included. This system would seem to me to be a fair and reasonable basis for the estate tax scheme if the concepts of "debts" and "encumbrances" were wide enough to include all liabilities or obligations of the deceased that have to be honoured by his estate and that go to reduce the net worth of his estate. Unfortunately, it seems to me that the concepts of "debts" and "encumbrances" do not embrace all of the deceased's liabilities and obligations that must be honoured by his estate.

The word "encumbrance" in this context means, as I understand it, a claim, lien, or liability that is "attached to property" (cf. Shorter Oxford English Dictionary). The word "debt", in the absence of a special statutory definition, means "a sum payable in respect of a liquidated money demand, recoverable by action" (cf. *Diewold v. Diewold*[3]). Moreover, Parliament appears to have used the word "debt" in section 5(1)(*a*) in a sense that did not include obligations generally for, by section 5(2), it is provided that a statutory debt or "other obligation" imposed by statute shall be deemed to be a "debt" that falls within section 5(1)(*a*). It follows, as it seems to me, that no deduction is permitted for any liability in damages or other such obligation not based on a statute, no matter how substantial such liability may be.

My analysis of the scheme of the *Estate Tax Act* leads me to the conclusion, therefore, that what was intended was that the "value" of all property passing on death should be included in computing the estate tax base, but that there can only be deducted, in that computation, the value of some, and not of all, obligations of the deceased that pass to the estate. In other words, there seems to have been a deliberate intention, in the framing of the scheme of the statute, to impose the estate tax on a tax base that might, in some cases, substantially exceed the net worth of the estate even in a case where none of the lettered paragraphs of section 3(1) have any application.

Having reached that conclusion, I do not have too much difficulty in coming to a decision in this case, strange as

[3] [1941] S.C.R. 35 at page 39.

1968

BEAMENT *et al* v. MINISTER OF NATIONAL REVENUE

Jackett P.

the result would have seemed to me as long as I continued of the view that the basic concept of the *Estate Tax Act* was to impose the tax on a base computed by reference to the net worth of the estate.

Here the deceased owned shares which, considered by themselves, carried control of the company and enabled the holder to continue indefinitely to obtain the income (after payment of preferred dividends) from a very large fund. The appellants have failed to show that such shares (considered as subjects of sale by themselves between a hypothetical purchaser and hypothetical vendor) had a value of less than the $110,000 attributed to them by the respondent. This is so, as it seems to me, even though, on the day of the death of the deceased, the particular owner (i.e., both the deceased and his estate) had an obligation to take certain steps as a result of which the shares would be converted into a cash amount of some $10,725.98. That is a result that did not flow from the nature of the property itself but from a contractual obligation assumed by a particular owner of the property. From the point of view of the scheme of the *Estate Tax Act,* such an obligation falls in the same class as debts and encumbrances—i.e. potential deductions—except that, for some reason that I do not understand, the statute does not permit deductions in respect of obligations of the deceased or his estate other than debts or encumbrances.

I should not leave the matter without referring to *C.I.R. v. Crossman et al,*[4] which occupied such a large part of the argument. If I properly appraise what was decided in that case, it can have no application to this case because that case dealt with a problem arising out of limitations on the rights of the shareholders that were carved out of the shares themselves by the statutory documents by which those shares were created, whereas here the shareholder had full rights, as far as his property rights flowing from ownership of the shares were concerned, to continue the company in existence or to cause it to be wound up and to sell all such rights to anybody else; but he had contracted a personal obligation to somebody else that he would cause the company to be wound up. If, in this case, there had been something in the constitution of the company whereby its

[4] [1937] A.C. 26.

winding up followed automatically upon the death of the holder of the Class "B" shares, I should have had no difficulty in holding that, on the day of the deceased's death, no person in a market situation, no matter how unrestricted the market, would have paid any more than $10,725.98 to acquire the shares in question.

The appeal will be allowed and the assessment will be referred back to the respondent for re-assessment in accordance with the "Partial Minutes of Settlement" and the amended reply to the notice of appeal. As the respondent has been successful on the question that has been subject matter of the appeal since the filing of the amended notice of appeal, the respondent will have all its costs arising since that time and the appellant will be entitled to all its costs arising before that time. The one amount will be set against the other and there will be judgment for the difference in favour of the party that taxes the larger amount. As the costs on the "Second Matter in Appeal" fall in the period in respect of which the appellant is entitled to tax costs under this disposition of the matter, I will not make a separate order as to the costs of the Second Matter in Appeal as I had originally intended to do.