The Transfer of Property on Death: Ownership, Control, and Vesting

Catherine A. Brown*

PRÉCIS

Depuis l'abolition des droits successoraux au Canada, le gouvernement fédéral a élaboré un ensemble complexe de règles sur l'imposition au décès et l'imposition de la succession et bénéficiaires. L'incidence fiscale du décès d'un particulier et, dans de nombreux cas, le traitement fiscal des héritiers, sont prescrits par ces règles. Bien que les mécanismes des dispositions soient relativement clairs, leur application et leurs conséquences après le décès ne le sont pas. Le problème découle du fait que des dispositions importantes contenues dans la Loi dépendent des termes employés, comme «propriété», «contrôle», «propriété effective» et «acquisition». Les différences de sens de ces termes à l'égard de l'impôt ne sont pas évidentes. Le moment où ces termes devraient s'appliquer pour établir les incidences fiscales sur la succession et les bénéficiaires et la manière dont ils devraient être appliqués ne sont pas plus évidents. Par exemple, à l'égard de l'impôt, quand l'exécuteur cesse-t-il de détenir le titre légal et bénéficiaire et détient-il uniquement le titre légal au nom des titulaires pour leur propre compte? Selon l'examen de l'auteur, ce moment peut donner lieu à des incidences fiscales importantes.

ABSTRACT

Since the abolition of succession duty in Canada, the federal government has developed a complex set of rules concerning taxation on death and taxation of the estate and beneficiaries. These rules prescribe the tax consequences of an individual's death and in many cases affect the tax treatment of the heirs. Although the mechanics of the provisions are reasonably clear, their application and their effect after a death are not. The difficulty lies in the fact that significant provisions throughout the Act are dependent on terminology such as "ownership," "control," "beneficial ownership," and "vesting." For tax purposes, the differences in meaning are unclear. It is also unclear when and how these terms should be applied in determining the tax consequences to the estate and the beneficiaries. For example, for tax purposes, when does the executor cease to hold legal and beneficial title and come to hold only legal title for those beneficially entitled? As the author discusses, this moment can have significant tax consequences.

* Professor, Faculty of Law, The University of Calgary. Special thanks to Doug Ast of Bennet Jones Verchere, Calgary, for his helpful comments.

INTRODUCTION

The moment when property vests in a beneficiary or when a change of ownership or control occurs can have important tax consequences. It may, for example, result in a change in corporate status, affect the ability to claim capital cost allowance, dictate the right or obligation to claim income amounts from or under a trust, and determine whether assets may be transferred on a rollover basis on death. Determining the moment can be difficult, however, for several reasons. Perhaps the most important is the problem inherent in transporting common law and statutory principles of vesting and assent to a tax statute that was not designed to be sensitive to the vagaries of estate administration. In addition, the common law rules that affect specific bequests appear to be different from those that affect residual gifts. Finally, it is not clear what the effect of common law principles of vesting will be in determining when control or beneficial ownership is transferred or when vesting occurs for tax purposes.

In this paper I will outline the common law position on vesting and the transfer of beneficial ownership on death. I will also discuss the tax consequences that are likely to result when these events occur. Particular emphasis will be placed on the change-of-control provisions, which may become operative on death, and specifically how those provisions, and the rules governing a change in beneficial ownership, will affect a privately held taxable Canadian corporation. Other areas affected by a change in ownership or control will also be discussed.

SHARES OF A PRIVATE CORPORATION

Shares of a private corporation, and in particular shares of a Canadian-controlled private corporation (CCPC), are particularly sensitive to the time at which a change in control or ownership occurs. Perhaps the most trenchant example of this sensitivity can be found in *Fawcett and Son*.[1] In that case, Henry Fawcett, the controlling shareholder of a CCPC, died two days before his corporation's year-end. He transferred his control shares by specific bequest to his son George, who also acted as executor. Notwithstanding the generous gift from his father, George found the CCPC that he himself controlled deemed to be associated with his father's, owing to the two-day overlap wherein he served as executor of his father's estate. The deemed association meant the loss of, or at best the sharing of, the small business deduction for George's CCPC.[2]

At issue before the Federal Court of Appeal was the question whether George Fawcett, as executor, took title to the personal assets, including the control shares of the corporation, immediately on the death of his father or only on probate of the will. A second issue was whether George,

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[1] *H.A. Fawcett & Son Ltd. v. The Queen*, [1980] CTC 293 (FCA).

[2] See section 125 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act. Section 125 provides for a substantially reduced rate of tax for qualifying CCPCs.

even with title as executor, could control the corporation during the year if he could not legally obtain letters testamentary before the end of the year. This question related to whether he was or could be in a position to assert control by exercising the voting rights attached to the control shares. As to the first issue, Ryan J held that "the title to the control shares, as personal property, would have vested by force of the will itself in George C. Fawcett, as executor, at the moment of his father's death."[3] Since the test of control is merely whether George held the legal and beneficial title to the shares in any capacity, he was clearly in control of his father's corporation as executor during the critical last two days of the taxation year.[4] In response to the question of George's control before letters testamentary were issued, the court held that vesting of title was not conditional on proof of the will; rather, the letters merely confirmed what had already transpired—a vesting of title in George as executor of his father's estate and as trustee for himself as legatee.

Although the specific problem that results from a testator's leaving control shares to an executor who is related to him or her can be addressed by simply naming someone else executor, consider an example in which a stranger was named executor and George was either the beneficiary of a specific bequest of the control shares or a residual legatee who would receive them from his father's estate. At what moment would George's CCPC be deemed to be associated with his father's?[5]

A similar question arises when one considers the status of a CCPC where shares are left to non-resident beneficiaries. Where the shares are control shares, CCPC status will be lost once those beneficiaries beneficially own or control them. Again, how does one determine when this moment has occurred?

A change in corporate control, other than when shares are acquired from the executor or through an estate from a related party,[6] will also deem a year-end to have occurred and a new year to have commenced.[7] This will affect, among other things, the use of loss carryforwards and other time-sensitive options otherwise available to the corporation.

The answer to the question of when control or beneficial ownership is transferred from the estate to the beneficiary will also affect the losses

[3] Supra footnote 1, at 296.

[4] See also section 256 if the executor is at arm's length.

[5] In a recent technical interpretation, Revenue Canada has suggested that in these circumstances the two corporations would be related from the moment of the testator's death by virtue of paragraph 251(5)(b). Revenue Canada's argument is that the beneficiary has an option in the form of a contractual right in equity that is enforceable against the executor. This logic may also extend to the association provisions that use the option provision in subsection 256(1.4). Technical interpretation of the Reorganizations and Foreign Division, January 12, 1993. See *Window on Canadian Tax* (Don Mills, Ont.: CCH Canadian) (looseleaf), paragraph 2388.

[6] Subsection 256(7).

[7] Subsection 249(1).

otherwise realizable on a share redemption by the estate and the use of loss carrybacks realized by the estate in the deceased's terminal year under subsection 164(6). If an estate transfers property to a corporation that immediately after the transfer is controlled by the estate, subsection 85(4) will apply to deny the capital loss that would otherwise arise on the redemption of the shares. In consequence, there will be no capital loss in respect of which a subsection 164(6) election can be made to offset capital gains that may have occurred in the terminal year. The importance of "control" in limiting the right to claim losses will therefore affect the structuring of buy-sell agreements and general planning for the disposal of shares of closely held corporations on death. For example, if a father gifts 40 percent of his shares to his son and the remaining 60 percent to his estate, in Revenue's view any loss arising on the redemption of the shares held by the estate, before a transfer of shares to the son occurs, will be denied, because the estate continues to control the corporation. In contrast, if the estate transfers the shares to the son before the redemption (even if the son is the executor or the trustee) the loss on the redemption will be allowed.[8]

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[8] Revenue was asked to specifically consider the following three situations:

Situation One

Father dies owning 100% of the common shares of Opco which he acquired upon incorporation of Opco. Father's will requires the estate to cause the redemption of 60% of the common shares by the corporation and to transfer the remaining 40% to his only son. The redemption of the shares will result in a deemed dividend and capital loss to the estate. The capital loss will be carried back against father's capital gain arising on death, pursuant to subsection 164(6).

Revenue Canada holds the opinion that the estate controls Opco immediately after the redemption so that subsection 85(4) would apply to the capital loss which the estate would otherwise realize.

Situation Two

This situation is the same as Situation One except that the son is the executor of the estate and the estate transfers 40% of the shares of Opco to the son prior to the redemption of the balance.

Revenue Canada feels that the trustees of a trust or the executors of an estate do not, simply because they manage and control the trust property under the terms of the trust deed or will, control the trust or estate. Moreover, the fact that the trustee of a trust or the executor of an estate controls a company in another capacity does not cause the company to be controlled by the trust or estate.

Situation Three

In this case, father owns 50% of the common shares of Opco and his wife owns the remaining 50%. No other shares are outstanding. Upon father's death, his shares are left to his estate with instructions that they be immediately redeemed. Father's wife is the executor of the estate.

Revenue Canada noted that its response to this situation is similar to that in Situation Two:

> We do not generally view the executor of the estate as controlling the estate and we do not view the estate as controlling companies controlled by the

(The footnote is continued on the next page.)

One of the most dramatic examples of the importance of timing in a change of beneficial ownership or control may be seen in the situation where 90 percent or more of the shares are gifted to Her Majesty in right of Canada or a province or Canadian municipality. This occurs, for example, when shares of private family corporations are left to a university foundation.[9] At the moment when beneficial ownership of the shares is transferred to the foundation, it appears that the private corporation becomes tax-exempt by virtue of the operation of paragraph 149(1)(d). This somewhat startling result occurs because the foundation is by statute an agent of the Crown.

The date on which the corporation's status changes will trigger a number of other tax results. Perhaps the most significant rule relating to the commencement of tax-exempt status is expressed in paragraph 149(10)(b), which deems the corporation to have disposed of each of its properties (except Canadian resource properties or foreign resource properties where the corporation ceases to be exempt) for an amount equal to the fair market value of each property at that time, and to have reacquired each property at a cost equal to that fair market value. Both the disposition and the reacquisition take place while the corporation is taxable. Expenses that relate to resource properties are carried over under the successor rules.[10] The deemed disposition applies to each property of the corporation, whether inventory, depreciable property, or capital property. Any income or capital gain or loss, as the case may be, is realized, and the cost of the property is equal to its fair market value at the time of the deemed disposition.

To the extent that taxable income is generated by any deemed disposition of corporate assets, appropriate charitable donations by the corporation to the foundation may be possible and will reduce its taxable income to zero. Timing may be an issue, since the deduction must be made "in the year." Once subsection 149(d) applies on transfer of beneficial ownership to the foundation, that change in control will deem both a year-end and a disposition of corporate assets. The problem is that the deemed disposition of corporate assets and the resulting tax liability will have occurred in one tax year, and the gift in another. A cash gift might be made to the foundation by the corporation before the change of control in anticipation

[8] Continued . . .

> executors in their personal capacity. Subsection 85(4) will not generally apply to the redemption of shares in Opco by the estate unless Opco is, immediately after the redemption, controlled, directly or indirectly in any manner whatever, by the estate.

Technical interpretation of the Reorganizations and Foreign Division, July 10, 1992. See *Window on Canadian Tax*, supra footnote 5, at paragraph 2045.

[9] See, for example, the Alberta Universities Foundations Act, SA 1991, c. U-6.5, as amended, and the British Columbia University Foundations Act, SBC 1987, c. 50, as amended.

[10] Section 66.7.

of the taxable income and liability that would result. In other words, if the deemed disposition would result in $100 of taxable income and a deemed year-end on April 1, 1995, a cash gift of $100 could be made by the corporation to the foundation on March 30.

OTHER ASSETS

The entitlement of a beneficiary to the tax benefits (such as capital cost allowance), attributes, or liabilities attached to a bequest will also be affected by the time at which beneficial ownership of the asset is transferred to that beneficiary. Resolution of the question of when vesting occurs will also prove important for the purposes of the rollover provisions in the Act. The potential impact on beneficiaries, together with examples, is discussed below under the heading "Revenue Canada's Position."

THE COMMON LAW POSITION

At common law, legal and beneficial ownership of the deceased's assets passes to the executor by virtue of his office.[11] The will then becomes operative as a result of the executor's acts. Viscount Haldane commented on the executor's role as follows:

> The position of an executor is a peculiar one. He is appointed by the will, but then, by virtue of his office, by the operation of law and not under the bequest in the will, he takes a title to the personal property of the testator, which vests him with the plenum dominium over the testator's chattels. He takes that, I say, by virtue of his office. The will becomes operative so far as its dispositions of personality are concerned only if and when the testator assents to those dispositions.[12]

When does a vested interest in the assets transfer from the executor to the intended beneficiaries? Viscount Haldane provided the following answer to this question:

> The office of executor remains, with its powers attached, but the property which he had originally in the chattels that devolved upon him, and over which these powers extended, does not necessarily remain. So soon as he has assented, and this he may do so informally and the assent may be inferred from his conduct, the dispositions of the will become operative, and then the beneficiaries have vested in them the property in those chattels. The transfer is made not by the mere force of the assent of the executor,

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[11] The exception to this rule was with respect to real property that devolved directly to the devisee or heir at law. By statute, real property now devolves on the personal representative in most jurisdictions.

[12] *Attenborough v. Solomon*, [1913] AC 76, at 82-83 (HL). Now that real property also devolves on the personal representative there is some question whether a written assent or deed from the personal representative to himself or herself is required, since transfers of land must be in writing. There is apparently such a requirement in the British Columbia Estate Administration Act, RSCB 1979, c. 114, as amended; however, there is no equivalent legislation elsewhere in Canada. For a further discussion of this issue, see A.H. Oosterhoff and E.E. Gillese, *Text, Commentary and Cases on Trusts*, 4th ed. (Scarborough, Ont.: Carswell Thomson Professional Publishing, 1992).

> but by virtue of the dispositions of the will which have become operative because of this assent.[13]

Although Viscount Haldane's authoritative comments shed some light on the mystery of assent, they do not describe how or when assent occurs or its effect on the moment at which vesting occurs. For example, is one to assume that assent, once given, affects vesting retroactive to the moment of death as anticipated under the will? Or is vesting truly delayed until this assent is given? There seems to be some modest support for the latter proposition if one accepts that "there can be no succession to property without administration."[14] However, this expression may only point to when the fact of vesting can be verified, rather than when it actually occurs.

Another important clue can be found in the common law principle that vesting is presumed to occur early—in fact, very early. There is substantial authority for the proposition that "the law presumes that the testator intended the interest to vest at his or her death or at the earliest moment thereafter as is consonant with the terms of the will."[15] Nonetheless, it still appears that a beneficiary under a will has no property interest in the assets of the estate until administration is complete, in contrast with the position of a trust beneficiary who has an immediate property interest in a trust.[16]

The moment at which a beneficiary attains anything other than an inchoate right in the administration of the trust can be further blurred by an executor who also serves as a trustee under the terms of the will. In cases where the two offices were held by the same person the courts have struggled with the moment at which the metamorphosis between executor and trustee took place; that is, when the executor ceased to hold both legal and beneficial title and instead held only legal title on behalf of the estate beneficiaries. This distinction became extremely important in *Attenborough v. Solomon*, a decision of the English House of Lords. In that case one of the executors and trustees pledged silverplate belonging to the estate to pawnbrokers. From an executor, the pledge would have passed title to the pawnbrokers. From a trustee, the pledge could not have been made without the consent of the co-trustee, which was never given. In rendering his judgment, Viscount Haldane commented that the executors had acted as though they had done all that was required as executors, and in fact there was no evidence that they had taken any further steps after passing the residuary account. He concluded that the executors had assented at a very early date to the dispositions in the will taking effect.

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[13] *Solomon*, supra footnote 12, at 83.

[14] See A.V. Dicey, *A Digest of the Laws of England with Reference to the Conflict of Laws*, 5th ed. (London: Stevens & Sons and Sweet & Maxwell, 1932), 336, as cited in *Fitzgerald*, infra footnote 20, at 106, and Oosterhoff, supra footnote 12. See also Rodney Hull and Maurice C. Cullity, eds., *Macdonell, Sheard and Hull on Probate Practice*, 3d ed. (Toronto: Carswell, 1981), 152.

[15] Oosterhoff, supra footnote 12.

[16] Ibid., at 78-79.

According to Haldane, "It follows that under these dispositions the residuary estate, including the chattels in question, became vested in the trustees as trustees."[17] Presumably at that moment the chattels were also beneficially owned by the beneficiaries under the trust.

One other matter to be factored into the timing of vesting or transfer of beneficial ownership is the executor's year. This is the first 12 months after the deceased's death and the period traditionally allowed to an executor to pay debts and generally settle the estate so that it is ready for distribution to the beneficiaries.[18] The rule that executors cannot be compelled to pay legacies or distribute income or capital to beneficiaries in the year is also well established at common law.[19] Does this rule operate to delay the transfer of beneficial ownership where the executor so chooses?

How is the estate planner to determine when a change of control occurs, when beneficial ownership is transferred, or when property vests in a beneficiary? Does a change of control occur on death, on assent by the executor, after administration, or after the executor's year? Do these events occur simultaneously? Does it matter whether the gift is specific or residual or whether the executor is intent on delaying or expediting administration of the estate? The case law in this area provides little guidance, although several decisions have addressed the nature of the interest held by a beneficiary in an unadministered estate. Perhaps not surprisingly, those cases were largely concerned with the imposition of estate or succession duties.

Residuary Beneficiaries

In *MNR v. W.T. Fitzgerald*,[20] the Supreme Court of Canada held that a residual legatee in an unadministered estate had no beneficial interest until the estate was administered. In *Re Livingston*, the Privy Council confirmed the view that a residual beneficiary held only an interest in the proper administration of the estate. In reaching this conclusion, however, Viscount Radcliffe relied on the fact that no beneficial interest could arise until the nature of the trust was known. In other words, no trust could arise because the residual fund would not be known until the estate was administered and the debts paid.[21] These cases are therefore limited in their precedential value to residual interests in unadministered estates.

An administered estate was discussed in *Solomon*,[22] where Viscount Haldane concluded that beneficial ownership passed on the assent of the

[17] *Solomon*, supra footnote 12, at 84.

[18] *Re Perrin* (1925), 28 OWN 173 (HC).

[19] See the discussion in Maurice Cullity and Catherine Brown, *Taxation and Estate Planning*, 3d ed. (Scarborough, Ont.: Carswell Thomson Professional Publishing, 1992), 386.

[20] [1949] CTC 101 (SCC).

[21] *Comr. of Stamp Duties (Q'd.) v. Livingstone*, [1965] AC 694 (PC).

[22] Supra footnote 12.

executor. It is difficult to draw any further truths from the decision, since assent was inferred some 14 years after the testator's death. However, in reaching his decision Viscount Haldane stated, "I think it is plain from the document that Mr. J.D. Solomon regarded the debts as having been all paid and the estate as ready to be held upon the trusts of the will which affected it in the hands of the trustees."[23] The case may therefore be authority for the proposition that beneficial ownership in the residue of an estate is transferred to the beneficiaries once assent has been given; such assent is to be inferred by a course of conduct once estate administration is complete, and after the passage of time and lack of further activity by the executors. This raises a further question: when is estate administration complete? Will the passing of accounts and/or the issuance of clearance certificates be considered appropriate or necessary prerequisites?

Specific Bequests

The logic that applies to delay the transfer of a beneficial interest in the residue of an estate does not fit as neatly when a specific bequest is analyzed. In *Re Livingston* the court found that no beneficial interest was transferred because "until administration was complete [it could not be said] of what the residue, when ascertained, would consist or what its value would be."[24] In short, a "certainty of trust object" argument was used to conclude that there could be no beneficial interest if there was as yet no trust consisting of the assets of the estate. This will not be the case with a specific bequest, although it is possible that such a gift may abate where there are insufficient assets in the estate to pay the debts.

In *Re Neeld*,[25] the English Court of Appeal addressed the issue of the time at which vesting and the right to demand payment of rents and profits from a specific bequest of property occurs. In that case, any person who became entitled under the will to "the actual receipt of the yearly rents and profits" of the property would become disentitled if he had not begun using the testator's name and coat of arms within the year. The critical question under review was when the year commenced. At the time of the decision, the administration of the testator's estate had not been completed. The lower court judge held that the relevant date was the date of the testator's death. Diplock LJ would have agreed but for the operation of the Land Transfer Act of 1897. Prior to that time "[t]here [was] no doubt that . . . the life tenant under the specific devise would have become entitled to the actual receipt of the yearly rents and profits of the land specifically devised on the death of the testator for the legal estate thereupon vested in the specific devisee (*Re Varley, Thornton v. Varley*)."[26] The law was altered by the Land Transfer Act, whose modern

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[23] Ibid., at 81-82.

[24] Supra footnote 21, at 708.

[25] [1962] 2 All ER 335 (CA).

[26] Ibid., at 358 (citing *Re Varley; Thornton v. Varley* (1893), 68 LT 665 (Ch. D.)).

equivalent is the Administration of Estates Act. That legislation passes title to the personal representative as trustee of the property but subjects it and the personal representative to the debts and other obligations of the deceased. The case distinguishes between assent, "which operates as a conveyance of the legal estate," and its effect with respect to vesting. According to Lord Diplock, "When the assent is given it relates back to the death of the deceased."[27]

Both these situations were distinguished from the moment when the legatee became entitled to "the actual receipt of the yearly rents and profits." Lord Diplock commented as follows:

> No doubt the personal representatives become accountable to the life tenant for the yearly rents and profits of the specifically devised land received by them from the date of the death of the deceased but we do not think that the life tenant can properly be said to be himself entitled to the "actual receipts" of such yearly rents and profits until the date on which either the legal estate becomes vested in him, by a vesting assent or conveyance executed by the personal representatives or he becomes entitled to require the personal representatives to pay over the yearly rents and profits to him, a date which, in our view, coincides with that on which he is entitled to require the personal representatives to execute a vesting assent. This deferment of his entitlement to "actual receipt" of the yearly rents and profits does not result from some ultroneous event en dehors the will as in *Re Petre's Settlement Trusts, Legh v. Petre*. It arises from the operation of the relevant legislation on the trusts of the will itself.[28]

In *Re Neeld* no vesting assent had been executed. The question was whether the beneficiary had yet become entitled to require the personal representative to execute such an assent. The court held that there was no such entitlement before the end of the executor's year and even then the personal representative was not obliged to assent. Regard for the state of the general administration of the estate was still required. The court found that no assent could be called for even though there was no likelihood that the specifically devised property would be required for the paying of debts. In the court's view, other matters, including litigation, provided ample justification for the personal representative's refusal to execute a vesting assent.

Summary

Case law suggests that the earliest point at which vesting would occur in the case of a specific bequest is at death—a vesting which is retroactive following the assent of the executor. In the interim it seems that the beneficiary's beneficial rights are subject to payment of the estate's debts. Further, the beneficiary has no right to demand vesting assent before the end of the executor's year, and "expiry of the executor's year does not, of itself, impose any obligation on the personal representatives to execute a vesting assent without regard to the state of the general administration of

[27] Ibid., at 359.

[28] Ibid. (citing *In re Petre's Settlement Trusts, Legh v. Petre*, [1910] 1 Ch. 290 (Ch. D.)).

the estate."[29] Nonetheless, an executor's assent could occur at any time; "this he may do informally and the assent may be inferred from his conduct."[30] Assent can, for example, be given shortly after the testator's death if it is readily apparent that a specific bequest will not be affected by the debts of the estate. Alternatively, assent can be delayed by the personal representative until administration is complete.

The matter is somewhat more complex in the case of the residue. Until the estate is administered, the beneficiary holds only an inchoate right. However, even if the legal representative wished to assent it appears that no beneficial interest could arise until the estate residue was clarified—that is, after administration was complete. At that point the executor could assent, and presumably the vesting would be retroactive to the date of death. The residual beneficiaries could not demand that assent be given until after administration is complete, and probably not until after the executor's year. Nonetheless, it is arguable that assent may be implied at an early date after administration is complete on the basis of *Solomon*. It follows that beneficial ownership cannot be transferred until assent is given.

Regardless of when vesting occurs, the most problematic tax issues are not contingent on the resolution of this alone, but rather on the time at which beneficial ownership or control is transferred to the beneficiaries.

REVENUE CANADA'S POSITION

Transfer of Title to the Executor

For tax purposes, both legal and beneficial title passes to the executor (personal representative) at the moment of the testator's death.[31] In addition, the potential to control passes to the executor under the standard *Buckerfield's* test,[32] which provides that "control" means the ability to elect a majority of the board of directors.

A number of arguments have been raised as to whether death should be the operative moment for these purposes. It has been argued that title passes only on probate of the will (or rather that title passes retroactively to the moment of death once probate establishes the validity of the will),[33] and that control passes only after letters testamentary have been issued[34] and the executor can legally act with respect to the property. These arguments have not been accepted by either Revenue Canada or the courts. In fact, on the issue of when title and control passes to the executor, Revenue Canada's overall position is consistent with common

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[29] Ibid.

[30] *Solomon*, supra footnote 12, at 83.

[31] See *Fawcett*, supra footnote 1, and *Clair, Administrator v. Levesque et al.* (1939), 14 MPR 53, at 59 (NB Ch. D.), cited in *Fawcett*, at 296.

[32] *Buckerfield's Ltd. et al. v. MNR*, [1964] CTC 504 (Ex. Ct.).

[33] *Fawcett*, supra footnote 1, at 296. A similar argument and solution presumably would be reached on an intestacy where letters of administration are issued. See, for example, *Re Harris* (1914), 30 OLR 83, at 86 (SC).

[34] *Fawcett*, supra footnote 1, at 295.

law principles—that is, that title and control pass to the executor at the moment of the testator's death.

Beneficial Ownership

For tax purposes, the next critical moment for the transfer of property will occur when beneficial ownership of the assets is transferred to the beneficiaries: when the executor ceases to hold both legal and beneficial title and instead holds only legal title as trustee for the intended beneficiaries. As we have seen, at common law this moment may depend on whether the assets are the subject of a specific gift or part of the residue of the estate. It can also depend on one's determining when the beneficiary has the right to demand payment or when the executor wishes to transfer beneficial ownership of the assets. For tax purposes, there are few guiding principles to determine the time of vesting or to assist in differentiating between the time of vesting and the transfer of the beneficial interest in the property.

The Income Tax Act does recognize a clear distinction between legal and beneficial ownership. A tax result is generally imposed only on a change in beneficial ownership. Paragraph (e) of the definition of "disposition" in section 54 excludes "any transfer of property by virtue of which there is a change in the legal ownership of the property without any change in the beneficial ownership thereof." In *Interpretation Bulletin* IT-437R,[35] the department provides the following commentary with respect to the ownership of, in this case, real property.

> In the common law jurisdictions, two forms of property ownership are recognized—legal and beneficial. Normally "legal ownership" exists when title is transferred to, recorded in, registered in, or otherwise carried in the name of a person [paragraph 2].
>
> The term "beneficial ownership" is used to describe the type of ownership of a person who is entitled to the use and benefit of the property whether or not that person has concurrent legal ownership. A person who has beneficial ownership rights but not legal ownership can enforce these rights against the holder of the legal title [paragraph 3].
>
> Since in most cases the same person has both legal and beneficial ownership, determining ownership on the basis of beneficial ownership alone is often not required [paragraph 5].

Paragraph 15 of IT-437R elaborates on the department's view of ownership by way of gift or inheritance. The date on which ownership is obtained is "the date he or she obtains a right to possess the property for his or her enjoyment."[36] Unfortunately, this statement begs the very question it purports to answer. When is the gift reduced to possession for

[35] *Interpretation Bulletin* IT-437R, "Ownership of Property (Principal Residence)," February 21, 1994.

[36] Ibid., at paragraph 15. Where ownership is determined by court order (for example, on marriage dissolution), IT-437R provides that the date of the court order will be considered the effective date on which ownership is acquired, or such other date as is considered reasonable if no effective date is specified in the order.

a beneficiary's enjoyment? According to Diplock LJ in *Solomon*, this is the time at which the beneficiary is entitled to call for a vesting assent.[37] It is at this time that the beneficial ownership vests in the possession of the beneficiary and the executor becomes trustee in relation to the property until the legal ownership is transferred to the beneficiary.[38]

Revenue Canada has expressed its view on vesting as follows:

> Property is considered to vest indefeasibly in the person to whom it is bequeathed when that person has an enforceable right or claim to the ownership thereof. This will be so even though the formal legal conveyance and registration of ownership of the property has not been completed. Accordingly, the ownership of property described in a specific bequest in a will will vest in the beneficiary immediately after the death of the testator. The ownership of property emanating out of a non-specific bequest will vest in the beneficiary when such property has been identified and the beneficiary has a binding right to receive it.[39]

Although at first blush it seems that "vesting" on death will result in the transfer of other proprietary interests such as "ownership," "beneficial ownership," and "control," this may not be the case for tax purposes. Vesting may simply mean that the beneficiary has a right to an asset that may not be defeated by a condition subsequent. It may have no impact on other tax results that depend on the transfer of control or beneficial ownership, such as whether corporations are associated or the status of a corporation as a resident, taxable, or non-taxable entity. This view seems to be supported by Revenue's practice. For example, as will be discussed under the heading "Income Allocations," Revenue Canada takes the view that beneficiaries have no right to demand income from estate assets during the executor's year and to include these amounts in income.[40] It seems inconsistent to suggest that, notwithstanding this, the beneficiary has beneficial ownership or control over the assets during that period.[41]

If Revenue Canada favours early vesting and an early transfer of beneficial ownership, some flexibility may be lost by the executor.[42] On the

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[37] Supra footnote 12, at 82.

[38] Ibid.

[39] *Interpretation Bulletin* IT-449R, "Meaning of 'Vested Indefeasibly,'" September 25, 1987, paragraph 2.

[40] See *Interpretation Bulletin* IT-286R2, "Trusts—Amount Payable," April 8, 1988. However, the beneficiaries' control and ownership rights arguably would attach before a tax clearance certificate was issued to the personal representative.

[41] Although Revenue Canada has stated that two corporations may be related from the moment of the estator's death if the controlling shareholder of one corporation is a beneficiary of the estate. See supra footnote 5.

[42] The decision in *The Queen v. A. Boger Estate*, [1993] 2 CTC 81 (FCA), suggests that Revenue Canada's position does not favour early vesting. However, Revenue Canada has stated that if an estate transfers control to a trust to avoid subsection 85(4), the anti-avoidance rules in subsection 245(2) could be used to deny the loss carryback. Technical interpretation of the Reorganizations and Foreign Division, November 18, 1993. See *Window on Canadian Tax*, supra footnote 5, at paragraph 2786.

authority in *Re Neeld*, however, the executor arguably has a choice of assenting early to effect a vesting or delaying the vesting and, arguably, the transfer of beneficial ownership. In some cases the executor may prefer the delay. For example, a gift of a controlling block of shares may not affect the tax status of a corporation as long as the shares are held by the estate, but a deemed year-end and association and control problems may occur once beneficial ownership is transferred.

As previously discussed, control and ownership may also affect the tax treatment of shares of small business corporations at death. One example cited was the case in which 100 percent of the shares of a small business corporation were transferred to the estate.[43] The father's will provided that 60 percent of the shares were to be redeemed and 40 percent transferred to his son. If the shares were transferred to the son first, the estate would consist of 60 percent of the shares. On redemption the corporation would be controlled by the son, since he would own the only outstanding shares. If the son was also the executor of the estate, the question arises whether subsection 85(4) would deny a loss on the share redemption. Revenue Canada has stated that the trustees of a trust or the executors of an estate do not control the estate merely because they manage the trust property. Further, the fact that the executor of an estate controls the corporation in another capacity does not cause the corporation to be controlled by the estate.[44] Thus, the control exercised by the executor in his personal capacity will not affect the estate's tax liability.[45]

Consider now the claim for entitlement to the $500,000 capital gains exemption. Assume that the son who is the beneficiary sells his shares to his spouse. Ordinarily the spouse would be required to hold the shares for 24 months before claiming the $500,000 exemption, since the estate is not related to her and the deeming provisions in paragraph 110.6(14)(c) will not relate her to the estate for this purpose because she was not a beneficiary. However, if her husband was the executor she is still arguably entitled to the $500,000 exemption. The shares were "not owned by anyone other than a person related to" the spouse. It is true that legal and beneficial ownership was held in the son's capacity as executor; for the purposes of the capital gains exemption, however, this separation of roles does not appear relevant. The son in his personal capacity will not control the estate for the purposes of the "loss," but he does "own" the shares for the purposes of completing a claim for the capital gains exemption, and he apparently will "control" the corporation for the purposes of the association rules on the authority in *Fawcett*.[46]

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[43] Supra footnote 8, situation 1.

[44] Technical interpretation of the Reorganizations and Non-Resident Division, July 20, 1992, supra footnote 8.

[45] See also subsection 256(7). Control of the corporation is also deemed not to have been acquired for the purposes of a number of other provisions in the Act.

[46] Supra footnote 1.

In addition to concerns about transfers of control or beneficial ownership of shares in closely held corporations, a number of other common situations may perplex the executor and affect the beneficiary's overall share of the estate. These include income allocations under a trust; capital cost allowance claims; the role of the executor-beneficiary; and the effect of provincial legislation.

Income Allocations Under a Trust

Whether a gift is specific or forms part of the residue of an estate, the income generated by all assets becomes part of the estate for tax purposes for the estate (trust) period. This result is based on the premise that, until the estate is administered and the debts paid, legal and beneficial title remains with the personal representative. Therefore, any income generated by those assets arguably forms part of the estate and should be taxable to it. This is Revenue Canada's view—at least, throughout the executor's year. Nonetheless, amounts paid or payable to a beneficiary may be deducted from the estate's income for tax purposes.[47] Revenue Canada will allow a deduction from the income of the trust and an inclusion in the income of the beneficiaries if the personal representative allocates the income to the beneficiaries in his or her accounts and all the beneficiaries consent.

Interpretation Bulletin IT-286R2 provides as follows:

> Under common law rules, the initial 12 month period for a testamentary trust, commencing with the date of the settlor's death, is referred to as the "executor's year" and the right to income of the trust is, during the executor's year, unenforceable by a beneficiary of the trust. In spite of such common law rules, where the initial taxation year of a testamentary trust coincides with the executor's year and where the sole reason for the rights of a beneficiary being unenforceable is the existence of an executor's year, the Department will consider the income of the trust for that year to be payable to the beneficiary or beneficiaries of the trust pursuant to subsection 104(24). However, if even one beneficiary of the trust objects to this treatment with respect to the executor's year, the income of the trust for that year, to the extent that it was not actually disbursed during that year, will be taxed in the hands of the trust. In any case where the trust has been wound-up and the final T-3 return is filed for a period which terminates before the end of the executor's year, the income of the trust (including taxable capital gains) earned for that period is considered to have been paid to the beneficiaries of the trust in the calendar year in which that period ends, except for any part of the trust's income that was disbursed by the trustee to persons other than beneficiaries pursuant to the deceased's will or the operation of law (e.g. the will stipulated that debts are to be paid out of income).[48]

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[47] Clearly, no beneficiary could normally demand payment during this period. This appears to be a compromise position that juggles the times when beneficial ownership (and hence the right to receive income generated by specific assets) passes and when vesting of the asset occurs.

[48] IT-286R2, supra footnote 36, at paragraph 6.

The discussion in IT-286R2 suggests that this practice is limited to the executor's year and that it will apply only if that year and the trust's taxation year coincide. It is not clear why Revenue Canada has imposed this restriction, unless there is some concern about income splitting with the estate for a prolonged period. Revenue Canada is also not consistent in its application of this policy. In *W.H. Grayson v. MNR*,[49] the taxpayer was the sole executor and beneficiary under a will. The estate appears to have been fully administered in its first taxation year, which coincided with the executor's year. It received interest income in that year and in the succeeding year, and the executor reported such income as income of the estate. The minister included the amounts in the taxpayer's income for each year on the ground that they were payable to him qua beneficiary, and the assessment was upheld. As well as being inconsistent with statements concerning current assessment practice, Revenue Canada's position appears to be incorrect in law as far as the income of that year is concerned: it clearly belonged to the estate. The fact that the taxpayer was both the sole executor and the beneficiary may well have contributed to the decision, although, strictly speaking, that fact should have been irrelevant.

Revenue Canada's position as stated in IT-286R2 with respect to the obtaining of consent from all beneficiaries before amounts are allocated for tax purposes may deny the rights of a beneficiary who has been given a specific bequest (or in some cases an identifiable portion of the residue). If the executor has administered the estate, beneficial ownership has arguably passed; the executor should be able to allocate the income generated by that asset to the legatee for both tax and accounting purposes. According to the interpretation bulletin, this allocation cannot be made if a single beneficiary objects. If vesting of a specific bequest passes on death and beneficial ownership is transferred on completion of administration, the consent of the other beneficiaries should not affect the rights of the specific legatee with respect to income generated by the asset and allocated to him or her for tax purposes.

Capital Cost Allowance Claims

The transfer of beneficial title may also affect the right to claim capital cost allowance (CCA). Before the passage of the 1988 tax reform provisions, CCA, terminal losses, and depletion allowances could be flowed through to a beneficiary. Now these deductions must be claimed at the trust level; a designation to the effect that amounts received by beneficiaries are not payable for tax purposes is then made by the trust. In the case of a specific bequest, the beneficiary may be in a much more favourable tax position if beneficial ownership (and therefore title) is transferred early, particularly if insufficient income is generated by the trust to absorb the potential CCA generated; or some of the benefit of the CCA may be indirectly allocated to other income beneficiaries under section

[49] [1990] 1 CTC 2303 (TCC).

104(13.1). A clear case could be made for a much enhanced tax position if beneficial ownership of the depreciable asset was transferred to the beneficiary at death or after administration of the estate, but certainly long before the winding up of the estate and the issuance of the T-3 return referred to in IT-286R2.

The Role of the Executor-Beneficiary

A number of provisions in the Act depend on whether assets have been "transferred [or] distributed or have vested in a beneficiary." Many of these are also time-sensitive. Consider, for example, transfers of "rights or things" on death. Subsection 70(3) provides, inter alia, that where a right or thing has been transferred to a beneficiary before the time for filing a separate return has expired, the amount received by the beneficiary on the disposition of the right or thing "shall" be included in computing his income for the taxation year in which he received it. The personal representative has until the later of one year after the date of death and 90 days after the notice of assessment is mailed to elect to file the separate return. A "transfer" to a beneficiary before that time will preclude this option. On the authority in *Solomon*,[50] the transfer to the beneficiary occurs after administration and on the assent of the executor. The executor who does not want to lose the right to file a separate return may have to take steps to establish that the residue has not been transferred to him in his capacity as beneficiary before the actual filing occurs.

The Act's rollover provisions also require vesting within a particular period. When does this occur if the executor is also a beneficiary of the estate? In *Fawcett*, counsel argued, inter alia, that once the executor obtained legal title to the shares, George Fawcett also obtained beneficial ownership in his own right. This view was apparently shared by Ryan J, who remarked, "The vesting of legal title in George C. Fawcett as executor, was immediate on the death of the testator, and the title vested in him as trustee for himself as legatee."[51]

The Effect of Provincial Legislation

Considerable confusion about the point at which vesting occurs for the purposes of the Act's rollover provisions has resulted from applications under provincial statutes. In the Federal Court of Appeal in *Hillis*,[52] it

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[50] Supra footnote 12.

[51] Supra footnote 1, at 296.

[52] *W.M. Hillis and I. Hillis v. The Queen*, [1983] CTC 348 (FCA). In a recent technical interpretation, Revenue Canada stated that an election under section 6 of the Family Law Act of Ontario, RSO 1990, c. F.3, as amended, to receive an amount from the estate will be treated as a disclaimer for the purposes of paragraph 248(8)(b). As a result, the spousal rollover will be available for property transferred to the surviving spouse in satisfaction of the election if the transfer is made under court order. The election by the surviving spouse under the Family Law Act will revoke any gifts provided to the surviving spouse under the will unless the will specifically provides otherwise; if there is no will, the election is

(The footnote is continued on the next page.)

was unclear whether the Saskatchewan Dependant's Relief Act could retroactively affect vesting for tax purposes. Two of the judges held that the provincial legislation could not affect a federal tax statute; they found that an order under the provincial act to transfer property to the spouse could not retroactively establish the date of vesting for federal tax purposes. Mr. Justice Heald dissented: he concluded that the disposition of property on or after death was a matter relating to property and civil rights, and therefore provincial law would control the application of subsection 70(6). The decision did not establish what the result would be if, for example, property transferred by will was subsequently the subject of an application under dependants' relief legislation. That matter was addressed in *Boger Estate*.[53]

In *Boger Estate* the minister sought to deny a rollover of farm property to the children on the basis that the property could not vest indefeasibly within the required period if a Family Relief Act application was outstanding against it. Mr. Justice Heald held that the property interest was granted under the will and had vested. He concluded that a vested interest was defeasible only if it was subject to a condition subsequent contained in the grant that created the interest, and rejected the minister's argument that the children's interest could not vest until the spouse's Family Relief Act application was settled. He did find that a portion of that interest was retroactively affected by the court order and that the rollover would not apply with respect to that portion. In rejecting the reasoning in *Re Livingston*[54] that the estate beneficiaries did not acquire any proprietary rights in the estate's property until the administration of the estate was complete and the assets ascertained, Mr. Justice Heald relied on provincial legislation, specifically the Devolution of Real Property Act.[55] The combined effect of sections 3, 9, and 10(1) of that act ensured that "beneficial entitlement" arises on death in Alberta and not at some later date.

The optimistic reader might conclude as a result of this decision that property rights established by provincial statutes will be operative for federal tax purposes. In *Hillis*, however, rights had not vested in the spouse by will prior to the court order, whereas in *Boger* the children's rights had vested by will and were only retroactively deposed in part by

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52 Continued . . .
deemed to be a disclaimer under the Succession Law Reform Act of Ontario, RSO 1990, c. S.26. Revenue Canada has restricted this interpretation to transfers of amounts permitted in the election and made by court order within 36 months of the date of death. It appears that Revenue Canada is anticipating the problem of vesting outside the 36-month period. It may be difficult, however, for Revenue Canada to maintain its position, notwithstanding the Family Law Act election, if property that was subject to the court order was also gifted under the will. See the technical interpretation of the Financial Industries Division, March 8, 1991, discussed in *Window on Canadian Tax*, supra footnote 5, at paragraph 1152.

53 Supra footnote 42.

54 Supra footnote 21.

55 RSA 1980, c. D-34, as amended.

the provincial family relief order. The matter might have been more clearly resolved if Mrs. Boger's increased share of the estate as a result of the provincial order had also been the subject of the reassessment.[56]

Where the rollover is to a trust, the fiction that the trust is an individual for tax purposes will further complicate the vesting issue. To meet the requirement that the property must vest indefeasibly in the trust, one must first determine "whether the requirement relates to the beneficial interests in the assets transferred to the trustees, to the legal title of the trustees or to some other notion of 'property' deemed to be held by the trust in the fictitious capacity as an individual."[57]

In the final analysis, the time at which vesting occurs for the purposes of the various rollovers will be determined under the provincial estate administration acts.[58] These statutes generally provide that property vests at death in the personal representative, who takes the property as trustee for the persons beneficially entitled. From recent case law it appears that this position remains unchallenged.[59] However, neither provincial legislation nor the cases that considered it have clarified the distinction between beneficial entitlement and beneficial ownership and control for other tax purposes.

PLANNING CONSIDERATIONS

Notwithstanding that this area of law is uncertain, some simple planning steps can be taken to avoid adverse tax consequences.

First, if the timing of the asset transfer is important, document accurately when the administration of the estate is complete and/or when assent by the executor occurs.

Second, when the estate assets include shares of a small business corporation, carefully choose the executor to avoid any associated-corporation problems. Also consider holding the control shares separately from the redeemable preferred shares in order to avoid the adverse consequences of the loss-denial provision of subsection 85(4). If shares are the subject of a specific bequest and the beneficiary is also a residual legatee, consider disclaiming the specific bequest. This may be particularly useful when timing of the transfer is an issue; for example, when shares of a small business corporation are bequeathed to a charity, the deemed disposition rules on control by a non-taxable entity must be considered.

Third, the role of the executor who is also a beneficiary should remain distinct and should be well documented.

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[56] See *Hillis*, supra footnote 52.

[57] Cullity and Brown, supra footnote 19, at 533.

[58] See, for example, the Ontario Estates Administration Act, RSO 1990, c. E.22, as amended.

[59] See the Alberta Devolution of Real Property Act, supra footnote 55, section 2, and *Boger*, supra footnote 42.

Finally, if the timing of access to tax attributes such as capital cost allowance is important, transfer the assets to the beneficiaries at the earliest possible date to ensure that the deduction can be claimed in their hands rather than at the estate level.

In a recent conversation with a colleague I inquired, "When does beneficial title transfer on death?" My colleague replied, "When do you want it to transfer?" In the end, that may be the correct approach to tax planning in this area.