

*Death Taxes in Canada, in the Past and in the Possible Future**

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PRÉCIS

Les impôts au décès, sous forme de droits successoraux, ont une longue histoire au Canada. Ces impôts ont été levés pour la première fois en 1892 par quatre provinces et les autres ont emboîté le pas peu de temps après. Le gouvernement fédéral a suivi en 1941, durant la Deuxième Guerre mondiale, en promulguant la loi intitulée Dominion Succession Duty Act, laquelle a été remplacée en 1958 par la Loi de l'impôt sur les biens transmis par décès, rédigée plus soigneusement. Il était recommandé, dans le rapport de la commission Carter, qui, durant les années 1960, a examiné tous les aspects de l'imposition fédérale, de remplacer ces formes traditionnelles d'impôt sur les biens transmis par décès par une notion universelle de revenu, selon laquelle les dons et les héritages seraient inclus dans l'assiette fiscale. Cependant, le gouvernement fédéral a refusé de suivre ce conseil, en grande partie en raison de l'inquiétude d'une «double imposition» qui découlerait de la levée d'un impôt sur le revenu à la matérialisation réputée au décès et de l'inclusion des héritages dans le revenu du bénéficiaire. Par conséquent, en 1968, un régime fédéral unifié d'imposition des dons et des successions a été adopté.

Cependant, dans le cadre de sa réforme fiscale d'envergure en 1971, le gouvernement fédéral a abandonné le domaine de l'imposition des successions. Les trois provinces qui levaient alors des droits successoraux ont augmenté leur taux et six autres provinces ont promulgué une nouvelle Loi uniforme sur les droits successoraux, qui comportait un certain nombre d'innovations importantes, dont la substitution des droits traditionnels sur les «biens transmis au décès» par une nouvelle forme de droits sur les «accessions» et la notion de «provinces collaboratrices». La constitutionnalité de l'assiette des accessions a été maintenue par la Cour suprême du Canada dans l'affaire *Ellett* en 1980. Cependant, puisque l'Alberta avait décidé de ne pas promulguer de nouveau une législation sur les droits successoraux, sa présence à titre de paradis fiscal au Canada à l'égard des impôts sur les biens transmis par décès a grandement influencé les autres provinces à abandonner le domaine des

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droits successoraux, effet qui est devenu beaucoup plus prononcé au fur et à mesure que l'incidence de la matérialisation réputée au décès à l'égard de l'impôt a commencé à se faire sentir. L'Ontario a abrogé sa Loi sur les droits successoraux en 1979 et le Québec, en 1986.

Durant les années 1990, il a été recommandé, dans le rapport de la commission sur l'équité fiscale de l'Ontario, de ne pas recommencer à lever des droits successoraux en Ontario, mais plutôt de promulguer de nouveau une loi sur l'imposition des successions au palier fédéral. Tout impôt sur le revenu payable à la matérialisation réputée donnerait alors droit uniquement à une déduction dans le calcul de la valeur imposable des héritages.

La promulgation de nouveaux droits provinciaux sur les successions semble peu probable dans un avenir rapproché, en partie en raison des limites constitutionnelles sur l'imposition provinciale, en particulier eu égard à la mobilité croissante des familles canadiennes, bien que ce domaine soit toujours sujet à controverse.

ABSTRACT

Death taxes, in the form of succession duties, have had a long history in Canada. The first such taxes were imposed in 1892 by four provinces and the others followed suit not much later. The federal government entered the field in 1941, during the Second World War, with the enactment of the Dominion Succession Duty Act, but this statute was replaced by the more carefully drawn Estate Tax Act in 1958. The Carter commission report, which reviewed all aspects of federal taxation during the 1960s, recommended the replacement of these traditional forms of death taxes with an all-embracing concept of income which would include gifts and inheritances in the tax base. However, the federal government declined to follow this advice, largely because of concern about "double taxation" which would result from the imposition of income tax on deemed realizations at death and the inclusion of inheritances in the recipient's income. In 1968, therefore, a unified federal gift and estate tax system was enacted.

However, as part of its major tax reform of 1971, the federal government abandoned the estate tax field. The three provinces which were then levying succession duties increased their rates of duty and six other provinces enacted a new Uniform Succession Duty Act, incorporating a number of major innovations, including the substitution of a novel form of duty on "accessions" in place of the traditional duty on "transmissions" and the concept of "cooperating provinces." The constitutionality of the accessions basis was upheld by the Supreme Court of Canada in the *Elliott* case in 1980. However, because Alberta decided not to re-enact succession duty legislation, its presence as a Canadian death tax haven had a major effect in influencing other provinces to abandon the succession duty field, an effect which became much more pronounced as the impact of deemed realization at death for income tax purposes began to be felt. Ontario repealed its Succession Duty Act in 1979 and Quebec, in 1986.

The report of the Ontario Fair Tax Commission in the 1990s recommended against the reimposition of Ontario succession duties, but it advocated the re-enactment of a federal estate tax, in which any income taxes payable in respect of deemed realizations at death would simply be deductions in computing the dutiable value of inheritances.

The enactment of new provincial succession duties seems unlikely in the near future, in part because of the constitutional limitations on provincial taxation, particularly having regard to the increased mobility of Canadian families, although this area continues to be controversial.

INTRODUCTION

Death taxes were a feature of the Canadian tax landscape for almost a century, until the federal government repealed its estate and gift taxes at the end of 1971; in 1986 Quebec was the last province to repeal its succession duty laws.

Succession duties were first levied in 1892 by Ontario, Quebec, New Brunswick and Nova Scotia. In 1893 they were introduced by Manitoba, in 1894 by Prince Edward Island and British Columbia, in 1905 (on becoming provinces) by Saskatchewan and Alberta.¹

The federal government first imposed death taxes in 1941 under the Dominion Succession Duty Act, applicable to the estates of persons dying on or after June 14, 1941. This was a hurriedly drafted statute, composed largely on the basis of bits and pieces from the death tax statutes of other jurisdictions. Unlike the provincial statutes, which used the expression “property passing on the death” to describe the basic scope of property subject to tax, an expression taken from the UK Finance Act, 1894, the Dominion Succession Duty Act used the expression “becoming beneficially entitled to property,” taken from a different British statute, the Succession Duty Act, 1853. Interestingly enough, however, whereas the rather esoteric meanings of these expressions were the subject of considerable judicial scrutiny in the United Kingdom, the fine points of British legal interpretation of these expressions seem to have been largely lost on Canadians. In practice, the scope of property subject to tax under any of the Canadian statutes has been largely based on property actually owned at death by a decedent and property which was deemed to have been so owned, by specific inclusionary provisions.

In 1958 the Dominion Succession Duty Act was replaced by the Estate Tax Act, which, by comparison, was a model of elegant drafting, composed under much less hurried conditions than the wartime legislation. Many parts of the Estate Tax Act seem to have been modelled to a considerable extent on US estate tax law.

¹J. Harvey Perry, *Taxation in Canada*, 2d ed. (Toronto: University of Toronto Press, 1953), 188.

THE REPORT OF THE CARTER COMMISSION

All aspects of the Canadian federal tax system were examined in detail by the Royal Commission on Taxation chaired by Kenneth Le M. Carter. The Carter report of 1966 is, of course, a landmark publication; however, its significance in the field of death taxes has turned out to be minimal. The reason for this is not hard to find.

The authors of that report rejected the long-accepted principle that a sound tax system does not rely on any single tax, but represents a balanced mix of taxes on income, consumption, and wealth. The attitude of the Carter commission should be contrasted with the more conservative approach of the Ontario Committee on Taxation, chaired by Lancelot J. Smith, which reported in 1967, not long after the Carter commission. In Chapter 1 of its report, in which the Smith committee stated its "The Committee's Philosophy of Government Finance: Taxation,"² it described what it calls the "principle of balance" in these words:

This principle is to be found in certain textbooks under such names as "multiplicity" or "plurality," but we have chosen the term "balance" in order to emphasize the kind of plurality that a tax system should possess. The need for a balanced plurality of taxes is grounded partly in the requirements of flexibility and elasticity, partly in equity, and partly in administrative considerations. As to flexibility and elasticity, it is readily apparent that some taxes are more flexible, others more elastic. Thus the property tax is relatively unresponsive to economic change but highly flexible, whereas consumption taxes are rather more elastic but relatively inflexible. A tax system should therefore have a sufficient multiplicity of taxes to take account of these characteristics. In the domain of equity, if a tax system is to conform to the basic rule of equal treatment of equals, it must not only be able to take differing individual situations into account but must also be virtually fool-proof in terms of evasion. If we may quote the Right Honourable Hugh Dalton, a former Chancellor of the Exchequer in the United Kingdom,

Anomalies as between persons, which are liable to arise under a single tax, are liable to be corrected under a multiplicity of taxes. And evasions, which may be comparatively easy under a single tax, are more readily detected under the check and counter-check which a multiple tax system may provide. Thus valuations for death duties and the previous income tax returns of the deceased may be checked against one another.

It is sometimes suggested that once a person has been taxed on his or her income, he or she should not be taxed a second time, when this income is spent on consumption expenditures, or at death, when unspent income forms part of one's wealth. Such a view is, of course, wholly at variance with the principle of balance espoused by the Smith committee. The justification for taxing wealth separately from income is that the possession of wealth, in itself, indicates capacity to pay taxes. Who can doubt that an investor with \$50,000 of investment income, but no other income, has a greater capacity to pay taxes than someone who earns the

² The Ontario Committee on Taxation, *Report*, vol. 1 (Toronto: Queen's Printer, 1967), 17.

same amount from a business or employment in which he or she is personally engaged? The investor's income can continue during illness or retirement and can be passed on to others at death, whereas the other kinds of income are dependent on the continuation of the business or employment. Similarly, the justification for taxation of consumption expenditures is that the tax is measured by the demands which an individual makes on the available resources of the society, which is measured entirely separately from the income he or she earns.

Instead of accepting the principle of balance, requiring more than one measure of taxability, the Carter report adopted an American theory, developed by Professors Haig and Simons, that sought a universal measure of ability to pay taxes and proposed that this measure should be the primary basis of the reformed tax system. (Scant consideration was given by the commissioners to the role of consumption taxes.) The Carter report proposed to treat every dollar received by a person in the same manner, whether it was received as ordinary income, capital gains, gifts, inheritances, or simply as windfalls.

Almost as soon as the report was published criticism was directed to this concept. Some critics directed their fire at the inclusion of gifts and inheritances in the same tax base as ordinary income. They argued that it was inappropriate to use the same system to tax large gifts and inheritances, which were received only sporadically, and typically only once in a generation, in the same manner as ordinary income, which for most people was received in regular, fairly even amounts. In addition, they could not accept the idea that making a gift or leaving an inheritance was to be regarded as making a sort of consumption expenditure, which would be ignored by the proposed tax system, while receiving a gift or inheritance would be regarded as enhancing one's ability to pay taxes. This would mean that if a group of people made gifts to one another they would be increasing their aggregate taxable capacity, which seemed absurd.

In addition, the report sought to preserve the symmetry of its proposed system of taxing capital gains by including provisions for deemed realization of gains on the death of an individual. That is, any gains that the individual had not realized during his lifetime would be subject to tax at his death. A number of critics pointed out, soon after the report was published, that the effect on the owners of businesses and on investors of deemed realization at death, when combined with the effect on their heirs of inclusion in their incomes of the inheritances they received, would involve tax burdens at death which were simply unacceptable. At the same time, even more vigorous criticism was directed to the inclusion of capital gains in the income tax base. This controversy resulted in heated debate, the effects of which are still with us.

The Canadian government responded to these criticisms in a particularly interesting way:

1) In 1968, soon after publication of the Carter commission report, it announced that it did not intend to include gifts and inheritances in the

tax base for income tax purposes. Instead, it enacted a unified transfer tax, subjecting to a tax, entirely separate from the income tax, the total of cumulative lifetime gifts plus the value of the decedent's property owned, or deemed to be owned, at death. This was a modification, but not a radical modification, of traditional death taxes. The system which applied under the federal statute after its reform in 1968 involved the application of gift tax to the annual gifts, other than relatively small exempt gifts and interspousal gifts, made by Canadian residents, in respect of property wherever it was situated, without any allowance for foreign gift taxes in respect of gifts of property situated elsewhere. At death, estate tax was levied on the total of the net value of property passing, or deemed to pass, on the death and the total of gifts made after 1968, plus the gift taxes paid by the donor on such gifts. This tax was then reduced by the total of gift taxes previously paid. This rather sophisticated system was similar to that subsequently adopted in the United States, in respect of its unified gift and estate tax.

2) After much debate, it decided that one-half of capital gains would be includible in the income tax base. This fraction was subsequently increased, first, to two-thirds, and now to three-quarters.

3) It neatly sidestepped the issue of the combined impact of traditional death taxes and the inclusion of unrealized capital gains in a decedent's income, by deciding that the federal government should get out entirely from the field of traditional death taxes. This decision caused few concerns to the federal government, which was by 1971 receiving only about 25 percent of the revenues from Canadian death taxes but almost 100 percent of the abuse heaped on such taxation by those who paid such taxes.

THE PATTERN OF DEATH TAXES IN 1971

The pattern of death taxes in Canada at the end of 1971 was rather complex, but it may be briefly summarized as follows:

1) In Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick and Manitoba, the federal government collected estate taxes on all estates at full rates, but it remitted to the provincial governments 75 percent of the revenues derived from each of these provinces, retaining only 25 percent for itself. Under sections 5(1) and 5(3) of the Federal-Provincial Fiscal Arrangements Act,³ 75 percent of the estate tax was remitted to the province in respect of:

- a) property situated in the province and included in the estates of persons dying domiciled in the province,
- b) property situated in the province and included in the estates of persons dying domiciled outside the province, and
- c) property (other than real property) situated outside Canada, passing to persons domiciled or resident in the province and included in the estates of persons dying domiciled in the province.

³RSC 1970, c. F-6.

This scheme of sharing of estate tax revenues reflected the pattern of succession duties, as they were then being levied by Ontario, Quebec, and British Columbia, the three provinces which levied their own succession duties at the end of 1971. While the federal government collected estate taxes on all property, real and personal, situated outside Canada and included in the estates of persons dying domiciled in Canada, it did not share the revenues derived from these taxes with the provinces, except to the limited extent noted in paragraph (c) above.

2) In Alberta and Saskatchewan, the federal government also collected estate taxes on all estates at full rates and remitted to the provincial government 75 percent of the revenues derived from these provinces, but both provincial governments rebated to the estate the province's entire share of these revenues, if the decedent died domiciled in the province or had resided in the province during the three years immediately preceding his death. (There was a slight difference between these two rebate schemes.)⁴

3) In British Columbia, the federal government collected estate taxes on all estates, but at only 25 percent of the full rate;⁵ the provincial government also levied its own succession duties on estates and property in the province, under legislation which was by no means identical to the Estate Tax Act.

4) In Ontario and Quebec, the federal government collected estate taxes on all estates, but at only 50 percent of the full rate, and it remitted 50 percent of the revenues derived from each of these provinces to the provincial governments. Both provincial governments also levied their own succession duties on estates and property in the province under their own statutes.

THE EFFECT OF THE 1971 TAX REFORMS

The reformed Estate Tax Act which was passed in 1968 was to have only a short lifetime, as it and the gift tax provisions of the Income Tax Act were repealed at the end of 1971, as part of the major tax reforms of that year. In its official *Summary of 1971 Tax Reform Legislation*, which accompanied Bill C-259, the federal government justified its decision to abandon the fields of gift and estate taxation in the following words:

In general, accrued gains on capital assets will be taxable at death. The combination of this provision with estate taxes could in some instances result in substantial tax impact arising on the death of a taxpayer. [Note that this constituted acceptance of the criticism mentioned above concerning the impact of two major taxes at death.]

⁴ See Wolfe D. Goodman, *The New Provincial Succession Duty System: An Examination of the Succession Duty Acts of the Atlantic Provinces, Manitoba and Saskatchewan*, Canadian Tax Paper no. 56 (Toronto: Canadian Tax Foundation, 1972), 3, at footnote 3.

⁵ Estate Tax Act, RSC 1970, c. E-9, section 9(1)(b).

The Commons committee [which reviewed the proposed legislation] recommended that the impact be lessened by a substantial reduction of estate taxes. The Senate committee recommended that the estate tax field should be vacated in favour of the provinces.

A reduction of estate taxes to the extent suggested by the Commons committee would result in a revenue loss of about half the \$55 million now received by the federal government from this source. Since 1964, provincial governments have received about 75 per cent of all death duties in Canada; 75 per cent of federal estate taxes are turned over to seven provinces and the others either levy their own death duties to the same extent or receive the equivalent amount by combining their own death duties and federal payments.

Two provinces [Alberta and Saskatchewan] now return their entire share of estate taxes to estates and it is no longer possible to establish a uniform national system of death duties through federal legislation.

In these circumstances, it has been decided that the federal government will vacate the estate and gift tax field on December 31, 1971.⁶

THE UNIFORM SUCCESSION DUTY ACT

When the federal government abruptly announced its intention to abandon the estate tax and succession duty field it invited those provinces which were not then imposing their own provincial succession duties to enact new statutes, to be administered on an interim basis by the federal government. The three provinces which were then imposing their own succession duties, British Columbia, Ontario, and Quebec, proceeded to increase substantially the applicable rates of duty, while six other provinces, the four Atlantic provinces, together with Manitoba, and Saskatchewan, under the aegis of the federal government, devised a Uniform Succession Duty Act; Alberta decided to continue not to impose succession duties.

The Uniform Succession Duty Act incorporated much of the wording of the Federal Estate Tax Act, with modifications reflecting the constitutional limitation on provincial taxing powers. It incorporated four new concepts which had never been tried before in Canada.

Tax on Accessions Rather Than Transmissions

In a joint policy statement issued by these six provinces on December 29, 1971, they stated:

Subjecting property which is situated outside the province to provincial succession duty also presents difficult problems of constitutional law. Earlier provincial succession duty laws have attempted to levy duty on personal property situated outside the province and only when such property passed on the death of a person dying domiciled in the province to a beneficiary who was either domiciled or resident in the province. These laws did not attempt to levy duty in any circumstances on real property situated outside the province, nor on personal property situated outside the province, unless

⁶E.J. Benson, *Summary of 1971 Tax Reform Legislation* (Ottawa: Queen's Printer, 1971), 36.

it passed from a deceased person within the province to a beneficiary within the province. This created a situation of unfair discrimination in the treatment of estates of equal value, depending upon whether or not they had assets and beneficiaries outside the province, and it was also conducive to tax avoidance. Accordingly, in future duty will be levied on all beneficiaries who are resident in the province and who receive inheritances of property of any kind, real or personal, which is situated outside the province, whether the deceased died domiciled in or outside the province. If the beneficiary is resident in more than one jurisdiction, only his principal residence will be taken into account.

The advantages of the accessions basis, as compared with the traditional transmissions basis for taxing the inheritance of property situated outside the province, were soon recognized in the other three provinces which had not adopted the Uniform Succession Duty Act. British Columbia did not replace its transmissions basis, but it added a new provision to its Succession Duty Act, section 6A, adopting the accessions basis. When Quebec made major reforms in its Succession Duty Act, in 1978, it eliminated the transmissions basis and adopted the accessions basis. Ontario did not enact such a change, although this was recommended in 1972 by a committee which advised the Minister of Revenue.

In *AG of BC v. Ellett Estate*,⁷ the Supreme Court of Canada dealt with the constitutionality of the accessions basis for levying succession duties, not under the uniform succession duty acts of the six provinces but under the rather similar provision, section 6A, in the British Columbia Succession Duty Act.⁸ In that case the court overruled the British Columbia Court of Appeal and upheld the constitutionality of this type of taxation as complying with the requirement in the Constitution Act permitting the provinces to levy only "direct taxation within the province."

Cooperating Provinces

A novel attempt at simplification of the succession duty system was made by the six provinces which adopted the Uniform Succession Duty Act. In their joint policy statement of December 29, 1971, they stated:

The co-operating provinces wish to simplify the administration of succession duties and to reduce the number of succession duty returns which will have to be filed in respect of any estate. They have therefore agreed among themselves that if the beneficiary of any property which is situated in a co-operating province is resident in another co-operating province the province of situs of the property will levy succession duty only if the property in question is real property. In such a case, the province of the beneficiary's residence will grant a credit in the manner described above [that is, a sort of foreign tax credit]. In all other cases where both the province of situs and the province of the beneficiary's residence are co-operating provinces, only the province of the beneficiary's residence will levy duty. If, for example, a beneficiary in co-operating province A receives a bequest of

⁷ [1980] CTC 338 (SCC).

⁸ RSBC 1960, c. 372, as amended by SBC 1972, c. 59.

shares of a corporation which are regarded as property situated in co-operating province B, only province A will levy duty. It is to be hoped that this simplified arrangement for collecting succession duty can be extended by agreement to the three other provinces which presently levy succession duty. Where this arrangement does not apply, a co-operating province will levy duty on all property situated within the province, with the exceptions previously mentioned.

As it transpired, none of the other three provinces, British Columbia, Ontario, and Quebec, took up this offer to become cooperating provinces. No doubt, this was because they considered that the vast bulk of the assets situated in their provinces and belonging to extraprovincial estates consisted of the shares of public companies whose transfer registers were located in their provinces. On the other hand, there were fewer public companies where transfer registers were located in the six provinces which enacted the Uniform Succession Duty Act. As a result, the three provinces had more to lose by forgoing taxation of such shares if they became co-operating provinces than they could gain by the exemption of estates within their provinces from similar taxation by the group of cooperating provinces.

Federal Collection

The federal government and the six cooperating provinces embarked temporarily, for a three-year period, on a scheme for federal administration of the succession duty acts of these provinces. While the federal government has, of course, administered the individual income tax systems of 9 of the 10 provinces, all but Quebec's, as part of the system under which it administers its own income taxes, this was the first, and only, time that the federal government administered a purely provincial tax.

Foreign Tax Credits

The dual nature of succession duty laws, which tax both property situated within a province and persons resident in the province, inevitably creates serious problems of double taxation, which were very imperfectly resolved under the various provincial succession duty acts, as they existed before 1972. Unlike the broad foreign tax credit system to which we are now accustomed in the income tax field, these statutes provided only very limited credits for death taxes imposed by other jurisdictions. A very far-reaching step was taken by the six provinces, when they enacted a system of unilateral foreign tax credits for "the amount of any estate, death, inheritance or succession tax or duty payable on that property [not situated within the province or within a co-operating province] under the laws of the jurisdiction in which the property is situated at the time of the death of the deceased." This provision was sufficiently broad to include taxes levied by a political division of a foreign state, as well as by the foreign state itself.

All six cooperating provinces and the three others which levied succession duties also enacted gift tax legislation, in the belief that this was necessary in order to protect the succession duty base. Whether gift taxes are really needed for this purpose may be doubted, bearing in mind the

United Kingdom's experience. In 1974 the United Kingdom enacted a capital transfer tax, subjecting both inter vivos gifts and transfers at death to a unified tax, rather similar to the present US estate tax. However, in 1984 this tax was replaced by an inheritance tax which generally exempted inter vivos gifts from taxation unless they were made within a certain period before death, in which case a percentage of the value of the gift, varying with the period before death, is included in the inheritance tax base.

REPEAL OF PROVINCIAL SUCCESSION DUTY ACTS

Within a very short time after the enactment of the uniform succession duty acts by the six provinces mentioned above, they began to be repealed one by one, first by Prince Edward Island, which retroactively repealed its legislation, so that it never took effect. New Brunswick amended its Succession Duty Act so that it applied only where the deceased died on or after January 1, 1972, and prior to January 1, 1974. Newfoundland's legislation was repealed, effective April 9, 1974. Nova Scotia's amended legislation applied only where the deceased died on or after January 1, 1972 and prior to April 1, 1974. The Saskatchewan legislation was repealed on January 1, 1977 and Manitoba amended its Succession Duty Act to limit the application of the Act to those who died on or after January 1, 1972 and before October 11, 1977.⁹

The British Columbia statute was repealed effective January 24, 1977 and Ontario's succession duty was abolished with effect from April 11, 1979. Quebec left the succession duty field in 1986.

The reasons for the abandonment of provincial succession duties are not hard to find.

1) Alberta declined either to enact the Uniform Succession Duty Act or to enact any other succession duty statute. Its status as a sort of Canadian death tax haven had a definite effect on cabinet members in other provinces, who were besieged by taxpayers who wanted the Alberta example to be copied in their province.

2) Concerns were repeatedly expressed about "double taxation," that is, the combined impact of subjecting property to deemed realization at fair market value at death under income tax legislation, as well as to succession duties on the net capital value of the estate. The Ontario government, with the assistance of a committee of professional people appointed by the minister of revenue, wrestled in 1972 with the difficult problem of providing some form of relief against the imposition of two major taxes at death.¹⁰ The committee recognized that the problem could have been resolved if the income tax rules enacted in 1971 had provided for a carryover of cost basis into the hands of those who inherited appreciated

⁹ *Estate Planning and Administration Reporter*, vol. 1 (Don Mills, Ont.: CCH Canadian) (looseleaf), section 10753.

¹⁰ Ontario, Advisory Committee on Succession Duties, *Report* (Toronto: Queen's Printer, February 23, 1973), 10.

property, rather than a deemed realization rule, but this would have required convincing the federal government of the merit of this change. Since the federal government had no interest in collecting succession duties and since it had objections to the indefinite postponement of taxation of unrealized appreciation of property, even for several generations, which would have been the result of accepting the carryover of cost basis, such a change was extremely unlikely.

As a second best alternative, the Ontario government adopted two strategies. First, it provided a system of gradual forgiveness, over a 10-year period, of succession duty in respect of the shares of small business corporations carrying on an active business, as long as the shares remained in the hands of the decedent's family. A similar forgiveness applied to farm property. Secondly, it provided a tax credit against succession duties otherwise payable in respect of income tax liabilities which arose at death under the deemed realization rules. It was impossible to justify this latter concession on theoretical grounds, since a person who sold appreciated property shortly before his death rendered himself liable to tax on his capital gain, which tax could only be deducted in calculating the taxable value of his estate for succession duty purposes, whereas, if he had held the property until his death and allowed his executors to sell it, the income tax liability on deemed realization at his death would have been fully creditable, on a dollar-for-dollar basis, against the succession duty liability. No doubt, it was for this reason that Quebec declined to allow such a tax credit, when it revised its Succession Duty Act in 1978. When the Ontario Fair Tax Commission made its recommendations for reinstatement of a federal estate tax, it specifically recommended that the income tax liability on deemed realizations at death simply be treated as a deduction in calculating the value of the taxable estate, rather than as a tax credit.

THE CASE AGAINST "DOUBLE TAXATION" AT DEATH

While there are theoretical arguments in favour of imposing both incomes on deemed realizations at death and death taxes on the net capital value of property owned at death, on the basis that the income tax liability arising at death is merely a sort of "catch-up" for taxes forgone while the decedent continued to own appreciated property, the argument against double taxation is seen by most experienced practitioners as extremely strong. If anyone were to doubt this, he or she should consider the tremendous uproar about the combined imposition of US estate taxes and Canadian income taxes at death on Florida condominiums and other US vacation properties owned by many Canadians. Under present law no relief at all is provided to Canadians against the combined effect of these two taxes at death. Relief in this situation eventually came only with the signing of the Third Protocol to the 1980 Canada-US Income Tax Convention on August 31, 1994.¹¹

¹¹ This protocol was drastically amended as regards the death tax situation by a revised protocol signed on March 17, 1995, which greatly improved the provisions relating to death taxes.

THE NDP PROPOSAL TO REINSTATE ONTARIO SUCCESSION DUTIES

In the weeks leading up to the provincial election of September 19, 1990, in Ontario, the New Democratic Party published a manifesto proposing, inter alia, the reinstatement of succession duties, curiously enough on the basis that the federal Conservative government had, by enacting its lifetime capital gains exemptions of \$100,000 (increased to \$500,000 for shares of small business corporations and farms), provided an untoward benefit to wealthy individuals. (Those who drafted this manifesto seemed to be unaware that, although the total amount of taxes forgone by the lifetime capital gains exemptions was substantial, these exemptions were of minor importance for really large estates with large amounts of appreciated property.) Soon after its election the New Democratic government appointed a Fair Tax Commission which extensively reviewed the whole area of provincial taxation, including succession duties. Although the commission's report¹² was strongly in favour of the reimposition of death taxes, it did not recommend their reinstatement at the provincial level. The commissioners stated:¹³

Although we have strong reservations about the feasibility of an Ontario-only wealth transfer tax, we are firmly convinced that a national wealth transfer tax would be a practical and beneficial addition to the current tax mix in Canada.

The report reviewed the history of wealth transfer taxation in Canada,¹⁴ stating as follows:

For our purposes, there are two important lessons to be drawn from the history of wealth transfer taxation in Canada. First, the federal government's decision to abolish its Gift and Estate Tax in 1971 indicates that the political willingness to tax wealth or wealth transfers depends on both the existence of a specific rationale for such a tax (distinct from capital gains taxes) and the net benefits for the taxing jurisdiction in terms of revenues raised versus collection and compliance costs incurred. Second, the disappearance of all provincial succession duties a little more than a decade after the abolition of the federal Gift and Estate Tax suggests that wealth transfer taxes (and perhaps other kinds of wealth taxes) are difficult to maintain at a provincial level, especially if other provinces are unwilling to impose similar taxes. The statements of successive Ontario treasurers throughout the 1970s also indicate that the decline and eventual abolition of Ontario's succession duty was motivated by a concern about the combined burden of the succession duty and capital gains taxes as well as by the technical impracticality of taxing wealth transfers at a provincial level or by the prospect of the relocation of wealth to other provinces.

The commission expressed no concern about the combined impact of income taxes on deemed realizations at death and its proposed national

¹² Ontario, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press, 1993).

¹³ *Ibid.*, at 386.

¹⁴ *Ibid.*, at 362.

wealth transfer tax. It specifically declined to recommend following the Ontario precedent, enacted in 1973, of allowing such income taxes to be creditable against succession duties. It is noteworthy, however, that no fewer than 8 of the 10 commissioners expressed written dissents to the report of the Fair Tax Commission, a number of them specifically targeting the wealth transfer tax proposals.

WHAT OF THE FUTURE?

Canada is among the few OECD countries not imposing traditional death taxes, although only Spain tries to tax both deemed realizations at death and the capital value of an estate. It should always be recognized that traditional death taxes, while very unpopular with those who pay them, contribute minuscule amounts to government revenues in most countries. As can be seen from the following figures supplied by some of the national reporters, there are only four countries in which the contribution equals or exceeds 1.5 percent.¹⁵

Norway	0.2%	Korea	0.6%
Colombia	0.2%	United Kingdom	0.8%
Italy	0.2%	Netherland	0.8%
Austria	0.3%	Spain	0.9%
Sweden	0.3%	Hong Kong	1.0%
New Zealand	0.3%	Belgium	1.5%
Finland	0.3%	Japan	1.6%
Germany	0.35%	Greece	1.7%
Denmark	0.4%	France	2.0%
Portugal	0.5%		

As mentioned above, the Supreme Court of Canada affirmed the constitutionality of the accessions basis of taxation in the *Ellett* case. Legislation on this basis has the merit of discouraging the emigration of wealthy elderly individuals to tax havens for the purpose of avoiding death taxes, since in many cases the beneficiaries of such individuals will continue to reside in the taxing jurisdiction, where they will be subject to tax on the accessions basis in respect of property situated outside the jurisdiction which they inherit from their relative who is now domiciled elsewhere. To this extent, the accessions basis is clearly superior to the transmissions basis, on policy grounds.

However, a major flaw still exists in this scheme, since it does not attempt to levy tax on property situated outside the jurisdiction which passes on the death of a person dying domiciled in the jurisdiction, to a beneficiary who is neither resident nor domiciled in the jurisdiction. This is a matter of increasing significance, as people become more mobile; it is much more common today for an elderly individual to leave property to beneficiaries residing outside the jurisdiction of his residence.

¹⁵ Wolfe D. Goodman, "General Report," in International Fiscal Association, *Cahiers de droit fiscal international*, vol. 70b, *International Double Taxation of Inheritances and Gifts* (Deventer, the Netherlands: Kluwer, 1985), 15-61, at 18.

The traditional response, which it is suggested is still correct, is that it would be beyond the constitutional power of a province to impose a death tax in circumstances where a person dying domiciled in the province leaves property which is situated outside the province to beneficiaries who are neither resident nor domiciled in the province. The decided cases, particularly *Cotton v. Rex*¹⁶ and *Provincial Treasurer of Alberta v. Kerr*,¹⁷ established the principle that a province is unable to levy succession duties on the estate of a decedent, because this would amount to levying an indirect tax. That is, such a tax would be imposed on a person, in this case, a notional person, the estate or the decedent's executors, who would not normally be expected to bear the burden of the tax. Consequently, most constitutional lawyers believe that it would not be possible for a province to levy an estate tax, similar to the federal tax which was repealed at the end of 1971.

However, some members of the Wealth Tax Working Group, which assisted the Ontario Fair Tax Commission, pointed out that Ontario presently levies income taxes on the estates of decedents, in respect of deemed realizations at death, although these taxes are collected on its behalf by the federal government. These members suggested that, if it is within Ontario's constitutional power to levy income taxes on this basis, by deeming the decedent to have disposed of his appreciated property immediately before his death at its fair market value, it is equally within its power to enact succession duty legislation which would levy a tax on the property situated outside Ontario of a person who died domiciled in the province, even where the person who inherited such property was neither resident nor domiciled in the province. All that would be required would be to levy the tax on the decedent himself immediately before his death.

They may be correct in arguing that if the Ontario income tax rules affecting decedents are constitutionally valid, a similar rule for succession duties could also be valid. That is, an estate tax could be levied on the property of an individual who died domiciled in Ontario, irrespective of the situs of his property or the residence or domicile of his beneficiaries, as long as the statute deemed the tax to be levied on the whole of his property immediately before his death. However, it is difficult to argue from the presumed constitutionality of Ontario income tax levied on deemed realization of a decedent's property immediately before his death, when the constitutionality of this tax has never been before the courts. Until a court has pronounced on the constitutionality of the income tax levied in these circumstances, it would be more prudent to assume that a province is constitutionally unable to extend the scope of its succession duty legislation to tax the estate of a decedent who was domiciled in Ontario, leaving property situated outside Ontario to beneficiaries who were neither resident nor domiciled in Ontario.

¹⁶ [1914] AC 176; (1913), 15 DLR 283 (PC).

¹⁷ [1933] AC 710; [1933] 4 DLR 81 (PC).

In his 1981 monograph, *The Allocation of Taxing Power Under the Canadian Constitution*,¹⁸ Professor Gerard La Forest, as he then was, a renowned constitutional lawyer, stated, “[I]t is not possible to levy duties in respect of property outside the province inherited by a nonresident even if the deceased was domiciled in the province.”¹⁹ Now that the author is a member of the Supreme Court of Canada, this statement carries even greater authority.

In *Re Upper Churchill Water Rights Reversion Act*,²⁰ McIntyre J, speaking for the Supreme Court of Canada, stated:

Where the pith and substance of the provincial enactment is in relation to matters which fall within the field of provincial legislative competence, incidental or consequential effects on extra-provincial rights will not render the enactment *ultra vires*. Where, however, the pith and substance of the provincial enactment is the derogation from or elimination of extra-provincial rights then, even if its cloaked in the proper constitutional form, it will be *ultra vires*. A colourable attempt to preserve the appearance of constitutionality in order to conceal an unconstitutional objective will not save the legislation.

This statement by our highest court can, I believe, be regarded as authority for the view that the extension of provincial succession duty legislation in the manner proposed would be *ultra vires*, as a colourable attempt to preserve the appearance of constitutionality to conceal an unconstitutional objective, namely, the imposition of an indirect tax, because such a tax would normally not be borne by the decedent, but by his heirs.

It is somewhat significant that the report of the Ontario Fair Tax Commission appears to have had some doubts concerning the views of those who assert the constitutionality of any kind of tax levied on decedents dying domiciled in Ontario, leaving assets situated outside Ontario to beneficiaries who are neither resident nor domiciled in Ontario. The report²¹ quotes, with apparent approval, the views of Professor La Forest cited above. Although it then goes on to mention the possibility that Ontario might attempt to tax worldwide estates of persons resident in Ontario at their deaths on the same basis that capital gains are subject to tax at death, by deeming the tax to be imposed on the taxpayer immediately before death, it does not cite any authority for the view that such a tax would be constitutional.

If the view is accepted that such a tax would be unconstitutional, the continued viability of provincial succession duties becomes problematic, now that families are more dispersed geographically. Consider two cases, both involving an individual domiciled in Ontario, with large estates of identical value, say, \$10 million, in the form of shares of a non-Ontario

¹⁸ G.V. La Forest, *The Allocation of Taxing Power Under the Canadian Constitution*, 2d ed., Canadian Tax Paper no. 65 (Toronto: Canadian Tax Foundation, 1981).

¹⁹ *Ibid.*, at 106.

²⁰ [1984] 1 SCR 297, at 332.

²¹ *Supra* footnote 12, at 390.

holding company. In one case, the beneficiaries are all resident or domiciled in Ontario, while in the other, they are all resident and domiciled elsewhere. If the Ontario government were advised that it could impose succession duties in the first case, but could not do so in the other case, would it be prepared to enact such taxes? Or would it be more likely to finesse the problem, in the manner of the report of the Fair Tax Commission, by recommending that the federal government, which is not bound by similar constitutional limitations on its taxing powers, be urged to reinstate the estate tax it repealed in 1971?

An additional complication arises because any succession duty which a province is likely to enact is likely to provide a complete exemption for property passing to a surviving spouse. This greatly enhances the opportunities for legal avoidance of succession duties, since it is usually much easier for the widow of a businessman to move to another jurisdiction than for the businessman himself to do so. If a widow changes her residence and domicile and at the same time changes the situs of her property to another jurisdiction, by transferring her assets to a company incorporated there, succession duty will be avoided for beneficiaries who are non-residents of the province of her former residence. Even if that province adopts the accessions basis for levying its succession duties, something Ontario never did, while it would be able to tax those of the widow's beneficiaries who were residents of the province, it would still be unable to tax beneficiaries who resided outside the province.

If any conclusions at all can be drawn from the tangled history of death taxes in Canada, they are perhaps as follows:

1) Reinstatement of provincial succession duties would be seen as increasingly unfair, in view of the apparent constitutional limitations on provincial taxation in respect of the foreign situs property of a decedent dying domiciled in the province, where the beneficiaries are neither resident nor domiciled in the province, and the increasing trend for such beneficiaries to reside in other jurisdictions.

2) As long as even one province declines to impose succession duties, it is extremely difficult politically for other provinces to maintain their own succession duty systems.

3) Reinstitution of a federal estate tax does not involve the two problems described above, but the combined application of income tax levied on deemed realizations at death and estate taxes levied on the net capital value of the decedent's property seems to be politically inadvisable, whether or not it can be regarded as "double taxation."

4) It might be politically possible for the federal government to reinstitute its estate tax if, but only if, it abandoned the principle of deemed realization at death for income tax purposes, substituting for it a carryover of cost basis from the decedent to his beneficiaries. However, it is unclear whether this would increase aggregate tax revenues, although it clearly would conflict with an important principle of tax policy which justifies taxing deemed realizations at death.