

BETWEEN:

F. DAVID MALLOCH MEMORIAL }
FOUNDATION

APPELLANT;

Toronto
1968
Dec. 13
Dec. 23

AND

THE MINISTER OF NATIONAL }
REVENUE

RESPONDENT.

Estate tax—Aggregate taxable value—Computation of—Residuary bequest to charitable foundation—Whether exemption reduced by amount of succession duty and estate tax—Estate Tax Act, 1958, c. 29, s. 7(1)(d).

A testatrix died in Ontario in 1967 and by her will gave her estate to trustees in trust (1) to pay her debts, funeral and testamentary expenses and all succession duties, estate and inheritance taxes on bequests out of her general estate, (2) to pay certain legacies and (3) to pay the residue of her estate to appellant (a charitable organization) for charitable purposes. The net value of her estate was \$847,836, legacies \$379,397, Ontario succession duties \$50,023, residue \$418,416. In assessing estate tax the Minister assumed that the residue was charged with estate tax.

Held, such assumption was incorrect. The exemption allowed by s. 7(1)(d) of the *Estate Tax Act* for the charitable bequest to appellant was not subject to decrease by the amount of Ontario succession duty and federal estate tax, since neither the will nor any applicable statute (see *Ontario Succession Duty Act*, R.S.O. 1960, c. 386, secs. 12 and 26; *Ontario Devolution of Estates Act*, R.S.O. 1960, c. 106, secs. 2 and 5; federal *Estate Tax Act*, S. of C. 1958, c. 29, s. 18) made succession duty or estate tax payable out of the property comprised in the charitable gift nor payable by appellant as a condition of such gift.

M.N.R. v. Buckle Estate [1966] S.C.R. 479, distinguished.

APPEAL from estate tax assessment.

Everett Bristol, Q.C. for appellant.

G. W. Ainslie for respondent.

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GIBSON J.:—This is an appeal from an assessment dated January 2, 1968, under the *Estate Tax Act* wherein an estate tax in the sum of \$59,592.04 was assessed in respect to the estate of Kate Daintry Malloch, deceased.

The special case stated by consent in this matter by the parties was as follows:

The Appellant is a non-profit corporation without share capital incorporated under The Corporations Act of Ontario on April 8, 1964, and is duly qualified and registered as a Canadian charitable organization (Registration No. 0135608-03-13). Since its inception all the resources of the Appellant Foundation have been invested to produce income all or substantially all of which has been devoted to the making of gifts to other organizations in Canada constituted exclusively for charitable purposes and similarly qualified and registered.

Kate Daintry Malloch died testate on April 13, 1967, and by her will, a true copy of which is filed and will be referred to, she provided for a substantial gift to the Appellant charitable Foundation. The executors appointed by her will duly made and filed within the prescribed time the Return of Information required by section 11 of the Estate Tax Act. The Appellant was not called upon to make or file a return as a successor under said will.

Kate Daintry Malloch left assets of an aggregate value of \$842,735 04 of which \$181,000 was in cash and bearer bonds, \$611,000. in Canadian listed stocks, \$35,000 in Ontario real estate and the balance in personal property. In addition there were gifts and dispositions inter vivos of \$12,025. which increased the revised total value to \$854,760 04. Aggregate net value (after debts) was \$847,836.85.

After deducting specifics and legacies totalling \$379,397. and Ontario succession duty of \$50,023 74, the value of the residue to the charitable Foundation, taking into account everything but estate tax, was \$418,416 11 Assuming the whole of the charitable gift to be exempt under clause (1) of section 7(1)(d) of the Estate Tax Act, net estate tax, after provincial credit, would be \$50,057.32

The Respondent assessed estate tax at \$59,592 04 on the assumption that the will gave the Appellant Foundation the residue of the estate charged with the burden of the payment of the estate tax payable in respect of property passing on the death of said deceased.

The question for the opinion of the Court is whether or not any part of any estate, legacy, succession or inheritance duties or any combination of such duties (including any tax payable under Part I of the *Estate Tax Act*) is, either by direction of or arrangement made or entered into by the deceased whether by her will or by contract or otherwise, or by any statute or law imposing such duties or relating to the administration of the estate of the deceased, payable out of the property comprised in the gift to the Appellant Foundation or payable by it as a condition of the making of such gift.

Section 7(1)(d) of the *Estate Tax Act* reads as follows:

7. (1) For the purpose of computing the aggregate taxable value of the property passing on the death of a person, there may be de-

ducted from the aggregate net value of that property computed in accordance with Division B such of the following amounts as are applicable:

(d) the value of any gift made by the deceased whether during his lifetime or by his will, where such gift can be established to have been absolute and indefeasible, to

(1) any organization in Canada that, at the time of the making of the gift and of the death of the deceased, was an organization constituted exclusively for charitable purposes, all or substantially all of the resources of which, if any, were devoted to charitable activities carried on or to be carried on by it or to the making of gifts to other such organizations in Canada, all or substantially all of the resources of which were so devoted, or to any donee described in subparagraph (ii), and no part of the resources of which was payable to or otherwise available for the benefit of any proprietor, member or shareholder thereof, or

(ii) Her Majesty in right of Canada or a province, a Canadian municipality or a municipal or other public body in Canada performing a function of government,

minus such part of any estate, legacy, succession or inheritance duties or any combination of such duties (including any tax payable under this Part) as is, either by direction of or arrangement made or entered into by the deceased whether by his will or by contract or otherwise, or by any statute or law imposing such duties or relating to the administration of the estate of the deceased, payable out of the property comprised in such gift or payable by the donee as a condition of the making of such gift;

By reason of the relevant words in the proviso of said section 7(1)(d), the court is concerned with three questions, namely:

1. Was any part of the estate tax and succession duties *directed* by the will of the deceased *payable out of* the property comprised in the gift to the Foundation?

or

2. Was any part of the estate tax and succession duties *payable out of* the property comprised in the gift to the Foundation *by reason of any statute or law* IMPOSING such duties or relating to the administration of the estate of the deceased?

or

3. Was any part of the estate tax and succession duties *payable by* the Foundation *as a condition* of the making of the gift to it?

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By clause IV of her will, all of the deceased's property in this matter, (except personal belongings and other chattels bequeathed to her daughter) was disposed of, the relevant provisions of which are as follows:

IV. I GIVE DEVISE AND BEQUEATH the remainder of my property and estate of every nature and kind and wheresoever situate to my Trustees upon the following trusts, namely:

(1) To pay my just debts, funeral and testamentary expenses and all succession duties, estate and inheritance taxes that may be payable in connection with any gift or benefit given by me to any persons either in my lifetime or by survivorship or by this my Will or any codicil thereto, it being my intention that all such debts, expenses, duties and taxes shall be paid out of my general estate so that all benefits and dispositions given or made by me in my lifetime or by my Will shall be free and clear therefrom.

(2) As soon as possible after my death to pay the following legacies:

Here follow legacies to the deceased's mother, sister and six god-children, totalling \$55,500.

(3) (a) To pay to my daughter, Mary Daintry Cole, the sum of Three Hundred Thousand Dollars (\$300,000) or, at her option, to transfer to her stocks and securities of equivalent value for the whole or part of said sum.

(4) To pay and transfer all the rest and residue of my estate to F. DAVID MALLOCH MEMORIAL FOUNDATION, a Corporation without share capital incorporated under the laws of Ontario, with the direction that the monies or property so given, or property substituted therefor, shall be held permanently by said Foundation and invested for the purpose of gaming or producing income to be used, applied or donated for such charitable and educational purposes as the Directors of the Foundation may from time to time determine.

The assessment above referred to assessed estate tax at \$59,592.04 by treating the charitable gift as subject to the last or "minus" paragraph of clause (d) of section 7(1) of the Act and by applying the method of "successive approximations" in computing the tax.

Each of the three questions that are cited above, involves the quaere of whether the gift to the appellant Foundation is or is not entitled to full exemption under sub-clause (i) of said clause (d). If so, the appellant claims to be entitled to the amount of estate tax overpaid in accordance with the assessment, namely, \$9,534.72, and interest thereon from date of payment.

The appellant among other things, submits:

1. that the first paragraph of the disposing clause IV of the deceased's will directed her executors and

trustees to pay all succession duties and estate taxes—"out of my general estate so that all benefits or dispositions given or made by me in my lifetime or by my will shall be free and clear therefrom". The second and third paragraphs of this clause provide for specific legacies totalling \$355,500. The fourth and final paragraph gives—"all the rest and residue of my estate to F. David Malloch Memorial Foundation";

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2. that therefore what the will gave to the charitable Foundation was all remaining property left after payment of debts, funeral and testamentary expenses, succession duties, estate taxes and legacies, subject to the testatrix's expressed intention that this gift and all other benefits given by her will should be free and clear of these duties and taxes;
3. that the will thus not only omits but expressly negatives any "direction" to pay estate taxes out of the charitable gift, and the fact that the amount of this gift cannot be ascertained until the amount of estate tax is known does not, in the absence of such direction, mean that the amount of the tax depends upon the amount of the gift so as to require the method of successive approximations to compute the tax;
4. that the only decided case dealing with the interpretation of section 7(1)(d) of the *Estate Tax Act* is *M.N.R. v. Bickle Estate*¹ and that this case is clearly distinguishable because of essential differences in language and intention between the Bickle will and that of Kate Daintry Malloch;
5. that the Bickle will left all his property to his executors upon three trusts. The first trust was—"to pay out of the capital of the residue of my Estate my just debts, funeral and testamentary expenses and all estate, legacy, succession and inheritance taxes or duties".

¹ [1966] S.C.R. 479.

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The second trust was to set aside, for the benefit of members of the Bickle family, a sum equal to 50 per cent of the value of the whole estate less only the debts.

The third trust was—"to pay or transfer the residue of my estate to E. W. Bickle Foundation". The use of the word "residue" in this trust as well as in the first trust, coupled with the express direction to pay out of "the capital of the residue" all estate taxes and other death duties, together comprised a definite and express direction to pay these duties out of this charitable gift and the Supreme Court of Canada so found.

Mr. Justice Judson, delivering the Judgment of the majority of the court, said:

At page 482 — The difficulty of the problem is that the value of the charitable gift is, by definition, the value of the gift minus duty *where there is a direction to pay duty out of the charitable gift*. One cannot ascertain the amount of the charitable gift without first knowing the estate tax payable, and in turn, the amount of the estate tax payable depends upon the amount of the charitable gift

And at page 484 — This will gives the charity the residue of the estate charged with the burden of the payment of the duty.

6. that the first paragraph above quoted from the Bickle judgment is clearly only applicable to a case where, as there stated, there is in the will—"a direction to pay duty out of the charitable gift", in which case the amount of the tax would depend upon the amount of the gift. Conversely, it is submitted that in the absence of such a direction or some other requirement in the "minus" clause the amount of the tax does *not* depend upon the amount of the charitable gift and the whole of the latter is exempt from tax;
7. that this "minus" clause provides for deduction from the total exemption of a charitable gift of such portion of estate tax or succession duties "as is,—

either by direction of or arrangement made or entered into by the deceased whether by his will or otherwise,

or by any statute or law imposing such duties or relating to the administration of the estate of the deceased, payable out of the property comprised in such gift or payable by the donee as a condition of the making of such gift.

Accordingly, one or other of the above two conditions must exist to justify any reduction of the statutory exemption and the onus of establishing this lies upon the taxing authority;

8. that for the reasons already given, no direction can be found in the will of Kate D. Malloch to pay duties out of the charitable gift; nor can it be suggested that there was any arrangement made or entered into by her to this effect;

9. that the remaining question is whether any portion of the death duties—“is, by any statute or law imposing such duties or relating to the administration of the estate . . . , payable out of the property comprised in such gift or payable by the donee as a condition of the making of such gift”; and

10. that the underlined are the significant words and, there is nothing in the significant words and, there is nothing in the *Estate Tax Act* or in any other applicable statute or law which, in the absence of a direction in the will, requires payment of such duties out of the charitable gift or by the donee thereof.

The respondent, among other things submits:

1. that under the last will and testament of the deceased, the testator, after bequeathing her personal effects, devised and bequeathed the remainder of her property and estate to her trustees upon the following trusts:

- (a) to pay all her just debts,
- (b) to pay certain legacies, and
- (c) to pay and transfer all the rest and residue of (her) estate to F. David Malloch Memorial Foundation;

2. that the law of Ontario, in respect to the payment of debts, is as follows:

- (A) Subject to section 37 of the *Wills Act* the real and personal property of a deceased person comprised in a residuary devise or bequest except so far as a contrary intention appears from his will or any codicil thereto, is applicable ratably according

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to their respective values to the payment of his debts, funeral and testamentary expenses and the cost and expenses of administration.

Section 5 of *The Devolution of Estates Act*,
 R.S.O. 1960, c. 106 and *Re Way*².

- (B) After the residue has been exhausted, the personal estate, unless the testator has exonerated it, is charged with the payment of the balance of the debts. But, it is not enough that the testator has charged his real estate with the payment of debts, it is necessary to find that the personal estate has been discharged.

*Re Hopkins*³

*Re Watson*⁴

*Re Banks*⁵

*MacWilliams v. MacWilliams & Ray*⁶

- (C) If the residue of the estate is not sufficient to pay the debts, and if after recourse is had to the balance of the personal estate of the testator, there still remains unsatisfied debts, the remaining real property will be chargeable in order that the balance of the debts may be satisfied.

Re Hopkins (supra)

*Re Swayze*⁷; and

3. that the estate tax payable on the property passing on the death of the deceased was payable out of the residue, that is to say, payable out of the property comprised in the gift to F. David Malloch Memorial Foundation.

So much for the submissions of the parties.

The estate tax payable levied under the *Estate Tax Act* against the executor of an estate of a deceased, by reason of section 18 of that Act, is deemed "to be a debt due to Her Majesty incurred by the deceased immediately prior to his death". Section 18 reads:

18. (1) Where any amount is payable as tax under this Part pursuant to section 13 by the executor of the estate of a deceased, that amount shall, for the purposes of any applicable statute or law relating to the administration of estates, be deemed to be a debt due to Her Majesty incurred by the deceased immediately prior to his death.

(2) Nothing in subsection (1) shall be construed as authorizing the deduction, under section 5 of any amount as or on account of the amount referred to in subsection (1).

² (1903) 6 O.L.R. 614.

⁴ (1922) 52 O.L.R. 387.

⁶ [1962] O.R. 407; 32 D.L.R. (2d) 481.

³ (1901) 32 O.R. 315.

⁵ [1905] 1 Ch. 547, 549.

⁷ [1938] O.W.N. 524.

Ontario succession duties levied pursuant to the *Ontario Succession Duty Act*, R.S.O. 1960, c. 386, are, by reason of section 12⁸ thereof, levied against every person to whom or for whose benefit any property situated in Ontario passed on the death of a deceased on the proportion of such property that so passed to him or for his benefit; and by reason of section 26⁹ thereof, the executor, trustee or person acting

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⁸ 12 (1) Every person resident in Ontario at the date of death of the deceased to whom or for whose benefit any property situate in Ontario passes on the death of the deceased is liable for the duty levied on the proportion of such property that so passes to him or for his benefit, together with such interest as may be payable thereon.

(2) Every person on whom duty is levied is liable for such duty, together with such interest as may be payable thereon.

(3) The duty levied by this Act shall be paid to the Treasurer.

⁹ 26. (1) An executor, trustee or person acting in a fiduciary capacity is not, as such, personally liable for any duty levied by this Act, but no person in Ontario shall pay, deliver, assign or transfer to or for the benefit of the person beneficially entitled thereto any property that is vested in him as an executor, trustee or person acting in a fiduciary capacity at any time after the death of the deceased without deducting therefrom or collecting an amount sufficient to pay the duty levied on the proportion of the property passing on the death of the deceased to or for the benefit of such beneficially entitled person and the duty levied on such person, together with interest thereon.

(2) Every such executor, trustee or person who transfers any such property without so deducting or collecting the amount payable by the person beneficially entitled thereto is guilty of an offence and on summary conviction is liable to pay to the Treasurer as a penalty an amount equal to 150 per cent of the amount of such duty, provided that any such executor, trustee or person is not so guilty or so liable if he so deducts from the property transferred or so collects an amount sufficient to pay the duty and interest payable by the person beneficially entitled thereto as claimed in a statement made pursuant to subsection 1 of section 34 or in any other claim made by the Treasurer or as determined by any court.

(3) Any executor or trustee or any person who has any money for the payment of duty, interest or penalties shall be deemed to be a person who has received money for the Crown or for which he is accountable to the Crown within the meaning of *The Financial Administration Act*.

(4) Any person who may be required under the will of the deceased or any trust created by the deceased to pay the duty levied on any property that has come into his possession, or is vested in him or is under his control, or levied on any person to whom there is a transmission of any such property or to whom a disposition of any such property is made, has, for the purpose of paying such duty or raising the amount of the duty when already paid, power to raise the amount of such duty and any interest and expense properly incurred by him in respect thereof, by sale, mortgage, lease or pledge, of so much of such property as may be necessary for such purpose.

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in a fiduciary capacity for the estate of a deceased person is required to deduct from the assets of the estate coming into his hands an amount "sufficient to pay the duty levied on the proportion of the property passing on the death of the deceased to or for the benefit of such beneficially entitled person and the duty levied on such person together with the interest thereof".

By *The Devolution of Estates Act*, R.S.O. 1960, c. 106, s. 2, all assets of a deceased person in Ontario come into the hands of an executor or administrator subject to the payment of debts. Said section 2 reads:

2. (1) All real and personal property that is vested in a person without a right in any other person to take by survivorship, on his death, whether testate or intestate and notwithstanding any testamentary disposition, devolves to and becomes vested in his personal representative from time to time as trustee for the persons by law beneficially entitled thereto, and, subject to the payment of his debts and so far as such property is not disposed of by deed, will, contract or other effectual disposition, it shall be administered, dealt with and distributed as if it were personal property not so disposed of.

(2) This section applies to property over which a person executes by will a general power of appointment as if it were property vested in him.

(3) This section does not apply to estates tail or to the personal property, except chattels real, of a person who, at the time of his death, is domiciled out of Ontario.

In the case of *Re Smith*¹⁰ the Court of Appeal of Ontario, Mr. Justice Middleton delivering the judgment at page 18, in interpreting this section, said:

By *The Devolution of Estates Act*, R.S.O. 1927, ch. 148, sec. 2, originally passed in 1886 and subsequently much amended, it is provided that all property, real and personal, which is vested in any person shall, notwithstanding any testamentary disposition, devolve to and become vested in his personal representatives as trustees for the persons by law beneficially entitled thereto, and subject to the payment of debts, and in so far as such property is not disposed of in the course of administration to be administered, shall be dealt with and distributed as if it were personal property not disposed of.

The effect of this statute is not to make real property personal property, but is to provide that real property shall descend to the same individuals as are entitled to receive and take personal property. It abolishes for this purpose the distinction theretofore existing between

¹⁰ [1938] O.R. 16.

the course of descent of personalty and realty, and provides that those entitled under the statutes to the personalty shall also be entitled in like manner to the realty.

The order in which the assets of a deceased's estate are to be applied in the discharge of the debts and liabilities is regulated by section 5 of *The Devolution of Estates Act*, and the general law, namely, the residue first and if the residue is insufficient for that purpose, then *seriatim* the personalty and the realty is resorted to.

Section 5 of that Act reads:

5 Subject to section 37 of *The Wills Act*, the real and personal property of a deceased person comprised in a residuary devise or bequest, except so far as a contrary intention appears from his will or any codicil thereto, is applicable rateably, according to their respective values, to the payment of his debts, funeral and testamentary expenses and the cost and expenses of administration.

(See also, *Re Hopkins (supra)*, and *Re Watson (supra)*).

In the case of *Re Hopkins (supra)* Mr. Justice Street at pages 317-18 states this proposition in this way, viz:

The Devolution of Estates Act, R.S.O. ch. 127, vests the real as well as the personal estate of a deceased person in his personal representatives for the purpose of paying his debts, but except in the case of a residuary devise of real and personal estate which is specially provided for by the seventh section, the order in which the different classes of property were applicable to the payment of debts before the passing of the Act does not seem to have been disturbed by its provisions.

In the case of *Re Swayze (supra)* Mr. Justice Hogg at pages 527-28 also re-states this proposition of law as to order of application of assets:

The Devolution of Estates Act by sec. 4, vests the real and personal estate of a deceased person in the hands of his personal representatives for the purpose of paying his debts, but except in the case of a residuary devise of real and personal estate, which is provided for, as has been pointed out, by sec. 5 of the Statute, the order in which the different classes of property are applicable to the payment of debts is not disturbed by the provisions of the Statute. The personal property of the deceased, unless there is something to the contrary expressed in the will, remains the primary fund for the payment of debts: *Re Hopkins Estate (1900)*, 32 O.R. 315

The statute law in Ontario "relating to the administration of the estate of the deceased" is in a number of statutes.

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One of the most important of these statutes is *The Devolution of Estates Act*. Among other things, it prescribes certain rules as to administration of estates and order of administration.

I now have to answer, in relation to this estate, the three questions posed above, with which, as stated, the court is concerned by reason of the relevant words in the proviso of s. 7(1)(d) of the *Estate Tax Act*.

1. Was any part of the estate tax and succession duties directed by the will of the deceased payable out of the property comprised in the gift to the Foundation?

In my view, no part of the estate tax and succession duties was directed by the will of the deceased to be payable out of the property comprised in the gift to the Foundation but instead, it is only in the residue of the residue of this estate that the Foundation has any property interest.

2. Was any part of the estate tax and succession duties payable out of the property comprised in the gift to the Foundation by reason of any statute or law IMPOSING such duties or relating to the administration of the estate of the deceased?

In my view, no part of the estate tax and succession duties was payable out of the property comprised in the gift to the Foundation by reason of any statute or law imposing such duty because, as noted, by the *Succession Duty Act* Ontario succession duties are payable by the beneficiaries, and by the *Estate Tax Act* estate taxes are deemed to be a debt of the estate incurred in the same manner as any other debt of the deceased prior to the death of the deceased and payable by reason thereof. Nowhere in *The Devolution of Estates Act*, and particularly at section 2 or at section 5 is there a statutory imposition of such succession duties or estate tax, nor, further, any requirement that such duties and estate taxes be payable out of the property comprised in the gift to this Foundation.

In addition, no part of the estate tax and succession duties are payable out of the property comprised in the gift to the Foundation by reason of any other statute or law "relating to the administration of the estate of the deceased". There is nothing in such branch of law imposing such duties or estate taxes, or so requiring.

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3. Was any part of the estate tax and succession duties payable by the Foundation as a condition of the making of the gift to it?

In my view, it is clear from the wording of this will that no part of the estate tax and succession duties were payable by the Foundation as a condition of making of the gift to it.

The appeal, therefore, is allowed with costs and the assessment is referred back for the purpose of re-assessing, not inconsistent with these reasons.