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THE ESTATE PLANNING IMPLICATIONS OF MARITAL DISRUPTIONS

By J. DAVID MURPHY*

I. INTRODUCTION

Marital disruptions, in the form of divorces, separations, and the like, are perhaps not yet as certain as death and taxes, but their implications may be becoming too important and costly to ignore. Though the impact of marital disruptions in Canada has certainly not reached U.S. proportions, Statistics Canada has recently reported that 36,704 divorces occurred in 1973, an increase of 12% over 1972. We may expect the statistics to rise as a result of past, and proposed, divorce reform.

There are few problems with which a solicitor may have to deal that present more hazards than domestic disputes. When tax considerations enter the picture, the potential for friction is increased substantially. As one American practitioner puts it, "The chemistry of cohabitation creates enough volatility between spouses before the addition of the financial element. When the money ingredient is mixed in, the combustibility index rises abruptly."¹ Another commentator likens divorce to a partnership dissolution "since many of these dissolutions — of both variety — are filled with animosity, jealousy, greed, and tax problems."²

It seems obvious that in situations of spousal animosity culminating in a negotiated settlement, much of the "sting" can be taken out of the financial settlement by proper tax structuring. More than anything else, estate planning in the context of marital breakdowns serves to underline the vital importance of the spousal relationship in our tax law. While the traditional aims of estate planning should be kept in mind by practitioners in the family law area, the tendency toward "automatic" estate planning should definitely be eschewed in favour of a conscientious appraisal of the particular domestic situation at hand.

It is apparent that the estate planning aspects of marital disruptions have not attracted the attention of Canadian commentators or practitioners to any significant degree.³ And, as will be seen, there are relatively few Cana-

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¹ Michel G. Emmanuel, *Property Settlements: Ante-nuptial, During Marriage, At Termination* (1966), 24 N.Y.U. Institute on Federal Taxation at 281.

² Joseph N. DuCanto, *Divorce and The High Cost of Leaving: Three Modern Tax Tales* (1973), 51 Taxes at 860.

³ The author is aware of only one Canadian contribution in this area: James T. Robson, "Estate Planning in the Family Dispute Situation"; in the Law Society of Upper Canada: Department of Continuing Education, *Family Law*, November 1974, Osgoode Hall, Toronto — and even this is a very brief treatment.

dian cases in this area. By contrast, the American case law and literature is voluminous; the author is aware of over 80 American periodical articles in the last fifteen years touching on some aspect of this topic. (However, even considering the degree of American interest in the subject, it may still be noted that the estate planning implications frequently are overlooked entirely in favour of purely income tax considerations.) As has been noted elsewhere,⁴ the problem has received little attention in the U.K. literature.

This study attempts to examine the estate planning implications of marital disruptions — primarily in the Ontario context — and, needless to say, breaks new ground to a significant extent. The approach will be to point out some of the estate planning problems that can arise in the particular context of marital problems. Little attempt will be made to outline in detail specific estate plans for specific situations; rather the study attempts a listing of problems that could arise, under several headings: succession duty problems, gift tax treatment, the transfer of capital property, real estate aspects, matrimonial property, life insurance, adopted children and stepchildren, *The Dependants' Relief Act*,⁵ will drafting considerations and *The Wills Act*.⁶ The study is useful not only because it attempts something that has received little or no attention before, but also because it affords a unique vantage point from which to view several different areas — tax and non-tax alike — of the estate planning field.

As stated, this study focuses primarily on the Ontario situation, though examples from other jurisdictions may be cited by way of comparison. It will be assumed that all parties and assets are located in Ontario; problems of *situs* and jurisdiction will not enter into this study. As well, it will be assumed that the domestic situations discussed involve estates substantial enough to make tax-oriented estate planning relevant. Further, most examples will involve, and discussion will be framed in terms of, the estate of a deceased husband. This is done merely out of convenience; it is recognized that in almost every case discussed, the roles of husband and wife could be reversed with identical results.

Certain themes will emerge from the study, and while these will be discussed in more detail, the most important of them should at least be listed here. One is the tendency of the legislation to speak only in terms of the spousal relationship; seldom is any attempt made to characterize the various *degrees* of relationship (along the continuum ranging from “romantic waltzes” to “violent Apache dances” as one U.S. judge has put it⁷) that may exist in the context of marital breakdown, or even to recognize that a spouse “in law” may not be a spouse “in fact”. Another is the fairly obvious fact that there is no clear boundary between estate planning and other forms of legal

⁴ A. J. Easson, *Estate Duty Aspects of the Matrimonial Property Questions* (1971), *British Tax Rev.* 356 at 357.

⁵ R.S.O. 1970, c. 126, as amended.

⁶ R.S.O. 1970, c. 499.

⁷ *Estate of Glen*, 45 T.C. 323 (1966).

planning of an individual's affairs. And related to this is a recognition of the necessity for a "separation and divorce planning" supplement to estate planning practice.

II. A GENERAL OVERVIEW, AND PRE-PROBLEM STAGE CONSIDERATIONS

Many specific tax and non-tax problems will be treated in the discussion which follows. It is sufficient at this juncture merely to note the very obvious fact that at the first sign of breakdown in a client's marital situation, the practitioner must give immediate consideration to altering the estate plan. Certain changes in the will will be necessary depending on the client's feelings toward his spouse. Adequate provision may have to be made immediately for the children in case the client should die before a final settlement is reached in divorce proceedings. Among other things, the client should recognize that in the event of divorce, spousal exemptions will be lost, and consequences will flow therefrom. The obligation to pay support after death, the problem of joint ownership of assets, and the life insurance considerations are examples of issues that are of immediate concern.

The revision of existing estate plans may be difficult enough even if there are no time constraints. Perhaps even more important though is the practitioner's ability to assess the client's marital situation *before* the initial estate plan is devised. "There is a feel or sense for human relations which a planner must have or develop if he is to become more than a tax expert or a theoretician. We must resist fitting clients, willy-nilly, into our favorite techniques or our favorite forms; i.e., we must resist automatic estate planning".⁸ Indeed, estate freezing and estate reduction, if carried to extremes, may be so successful as to leave the client completely at the mercy of his family. The problem can become particularly critical in a separation situation where property has previously been transferred to the spouse.

Though this may be difficult, it is incumbent upon the practitioner to probe into the marital situation before he can construct his estate plan, for the consequences of a marital disruption can be severe. In this regard, most practitioners agree that a previous marriage and divorce is a definite danger sign. In addition, it would seem prudent to take into account the client's religious and ethnic background in an attempt to assess the likelihood of divorce and remarriage. One should consider the wealth and youth of the parties involved; practitioners are understandably wary of substantial *inter vivos* transfers between young spouses in view of the difficulties that a later divorce can bring.

*Steinberg v. Steinberg*⁹ is a graphic illustration of the importance of doing everything possible to ensure that the marriage will be a stable one before bringing a spouse into estate planning arrangements. There, two years

⁸ Thomas A. Melfe, *Estate Planning in Connection with Divorce and Separation* (1968), 107 *Trusts and Estates* at 726.

⁹ (1964), 45 D.L.R. (2d) 162 (Sask. Q.B.).

after transferring shares to his wife as a gift, and in furtherance of an estate planning arrangement, the plaintiff caused his wife to sign promissory notes for the value of the shares to "help him out" in avoiding gift tax. The parties were cohabiting harmoniously at the time the notes were signed but subsequently they separated. The plaintiff brought an action on the notes, and failed. It was held that no legal relationship was intended to be established between the parties and accordingly no legal consequences or obligations arose from the signing of the notes, which, in any event, because the shares were a gift to the wife, were unsupported by any consideration. The mood of a marriage can change, but the fact that it was harmonious at the time of the *transfer* was sufficient in this case to characterize the transfer. Tucker, J. asked "... should the Court now because they are no longer living together give judgment whereunder the defendant must do something it was never intended she should have to do, namely, pay from her own resources the amount set out in the notes sued on?"¹⁰ He answered in the negative, and the plaintiff found himself losing \$15,000 in shares as a result of his attempt to save \$1,600 in gift tax.

III. NATURE AND EFFECT OF SEPARATION AGREEMENTS AND DIVORCE DECREES

At this juncture, a brief word is necessary regarding the financial implications of separation agreements and court decrees. A short discussion at this point will serve to clarify matters to be discussed below (especially the portions dealing with "debts of the estate").

What if a husband covenants to pay a periodic sum as support for his wife until her death or earlier remarriage without expressly purporting to bind his personal representatives? The leading case of *Kirk v. Eustace*¹¹ establishes that the estate is still liable to continue the payments. In that case it was held that the language used did not show any intention that the husband's obligation was to continue only during his life, and his estate was held liable to continue the payments. In each case the exact form of the words used and the whole of the document must be considered; slight indications may sway the construction.¹² One begins to appreciate the argument that estate planning should *extend* into the drafting of separation agreements.

Following from the courts' unwillingness to imply a term to the effect that the agreement operates only during the subsistence of the marriage, it has been held that such an agreement may be enforced notwithstanding the dissolution¹³ or annulment¹⁴ of the marriage.

In Ontario divorce cases the usual situation is for the terms of the separation agreement to be incorporated into the divorce decree. By section

¹⁰ *Id.* at 171.

¹¹ [1937] A.C. 491 (H.L.). See, also, *Cox v. Gale*, [1949] 4 D.L.R. 543 (Alta. C.A.).

¹² *Langstone v. Hayes*, [1946] K.B. 109.

¹³ *Newing v. Newing* (1952), 6 W.W.R. (N.S.) 698, *aff'd id.* 702 (Alta. C.A.).

¹⁴ *Adams v. Adams*, [1941] 1 All E.R. 334 (C.A.).

11 of the *Divorce Act*,¹⁵ the support award is at the discretion of the court; however, if the terms are reasonable considering the needs, and the parties had independent advice, it is unusual for the separation agreement terms to be altered. It should be noted that section 19(1)(d) of the Act authorizes the making of rules "providing for the registration and enforcement of orders made under this Act *including their enforcement after death*".

Needless to say, executors face problems when they discover that one of the liabilities of the estate is an unsecured claim for maintenance for an indefinite period. One can see how in the case of small estates especially this can cause considerable difficulty.

IV. THE SUCCESSION DUTY ACT

This section of the study attempts to point out some of the issues, important in the context of marital disruptions, that are raised in particular sections of *The Succession Duty Act*.¹⁶ Perhaps the most important issue, to be dealt with in depth below, is the question of what constitutes a debt of the estate. Another issue which arises in several sections is the importance of the spousal relationship. It is essential, when considering the legislation, to appreciate the difference between a *divorce* situation where there would no longer be a spouse (except in the case of remarriage in which case there would be a new spouse), and a *separation* situation where, despite the bad feelings prevailing, there is still the original spouse, in which case certain undesirable tax consequences may be avoided.

Definitions

It is not proposed to embark upon a lengthy discussion of the various modes of "disposition" listed in section 1(g). Suffice it to say that these may encompass any number of forms of transfer that participants in a marital breakdown — whether pre- or post-separation or divorce, or, indeed, perhaps even by way of separation agreement — might be involved in between themselves. (Examples might include a voluntary lump sum payment by one spouse to "get rid of" the other.) The extent to which transfers made pursuant to separation agreements or divorce decrees are then taken out of the "disposition" category is the subject of later paragraphs.

With respect to section 1(g), particular attention might be drawn to item (xi), "any contribution of any property of the deceased to a joint tenancy . . .". There, marriage is expressly deemed not to constitute consideration for any disposition.

The section 1(k) definition of "member of the family" includes

- (i) a child,
- (ii) a son-in-law or daughter-in-law of the deceased,
- (iii) a person adopted under *The Child Welfare Act* by the deceased or the spouse or any lawful descendent of such spouse,

¹⁵ R.S.C. 1970, c.D-8.

¹⁶ R.S.O. 1970, c. 449, as amended.

- (iv) the spouse of the deceased, . . . and
- (vii) the father, mother or any brother or sister of the spouse of the deceased or any lawful descendent of any such brother or sister.

Obviously the key words (as in other sections of the Act) are "spouse of the deceased". The Act really does not take into account the various situations and relationships that marital disruptions can create. There seems little room for quarrel with the proposition that the Act uses "spouse" in the sense of "such spouse as existed at the death of the deceased". Obviously, certain consequences flow from this: a person may have been a "member of the family" at the time of a particular disposition, but *not* at the time of the death of the donor (because the "spouse" creating the link was no longer the "spouse"). On the other hand, could one attempt the argument that "spouse of the deceased" includes *any* (past or present) spouse? There is room for clarification in the statute's language.

Section 1(d) defines a "child" as

- (i) a legitimate child of the deceased,
- (ii) a person adopted by the deceased,¹⁷
- (iii) a person to whom the deceased or the spouse of the deceased stood *in loco parentis* during the infancy of such person, and the deceased *while married to such spouse* shall be deemed to have stood *in loco parentis* to a legitimate child of such spouse and to a person adopted by such spouse, or
- (iv) a legitimate lineal descendent of any person defined in subclause i, ii, or iii.

Re Ramer,¹⁸ a case interpreting section 1(d)(iii), demonstrated a problem that can arise when one takes a bequest from his stepmother. There it was held that the relationship of a person and the stepmother his natural parent marries *after* the person's "infancy" does *not* come within this section. He is therefore not within the class of preferred beneficiaries in section 7(1), and the father's estate, inherited *through the stepmother*, must be taxed as though received by a stranger. This seems an unjust result, especially when the actual relationship may be very close. Indeed, in *Ramer*, Houlden, J. noted that "The relationship between them was likely much closer than exists between many mothers and their natural daughters . . ."¹⁹

Section 1(e) defines a common law spouse for purposes of the Act. Section 1(v) provides that "spouse" — a key word in the Act in the present context — shall "*include*" a common law husband or common law wife. This gives rise to an unusual result in the case where a husband, for example, has been separated from his legal wife for some years and has instead been living with a "common law wife" within the meaning of the Act. It would appear that the husband could have *two* spouses for purposes of the Act. It should be noted that the Smith Report²⁰ recommended that "spouse" status (for purposes of exemptions) be conferred not only on common law spouses but also

¹⁷ See Part X *infra*.

¹⁸ [1971] 2 O.R. 350, 17 D.L.R. (3d) 686 (H.C.).

¹⁹ *Id.* at 353.

²⁰ *Report of the Ontario Committee on Taxation, Vol. III: The Provincial Revenue System, "Treatment of Family and Dependents"* 176 at 179.

on "relative[s] whose major occupation was the care of the deceased", i.e., generally, "to a person who, during the five years prior to the death of the deceased, resided with him, was dependent upon him and managed his household without remuneration". However, this was recommended only to apply "in the absence of an exemption to a spouse".²¹ The actual legislation, somewhat strangely (though typically), does not allow for such a *replacement* of the *de jure* spouse by the *de facto* "spouse" but seems to allow room for both.

Exemptions from duty and from aggregate value

Two items within section 5 of the Act (i.e., exempt from duty and not includable in aggregate value) are important in the present context. They are

- 5(1)(f) any disposition for necessities or education to or for *any member of the family* of the deceased where it is shown to the satisfaction of the Minister that such member was dependent in whole or in part on the deceased for such necessities or education; and
- (g) any disposition where actual and *bona fide* enjoyment and possession of the property in respect of which the disposition is made, was assumed more than five years before the date of death of the deceased by the person to whom the disposition is made, or by a trustee for such person, and thenceforward retained to the entire exclusion of the deceased or of any benefit to him whether voluntary or *by contract* or otherwise. (emphasis added)²²

Section 5(1)(f) would seem particularly relevant in a case where a father, for example, wishes, or is obligated, to pay for the education of children who are in the custody of the mother. The children need only be dependent "in part" upon the father. The definitions of "child" and "member of the family" should be referred to. It would seem that 5(1)(f) could exempt payments for necessities or education of the children of a widow who remarried the deceased, though the children may not in fact have been adopted by the deceased.

Section 5(1)(g) has been commented upon extensively elsewhere and is obviously a key provision in the Act. The intention here is merely to point out some issues that arise in the context of marital disruptions. The section is clearly not too relevant in the case of dispositions to spouses within five years of death because of the total spousal exemption granted by the Act (though the amount will still be includable in the aggregate value of the estate). Problems arise though when the spousal relationship has terminated.

Consider the situation where a wealthy husband makes any sort of "disposition" to his wife (for example, a large lump sum payment "to get rid

²¹ *Id.*, s. 138. See, also, The Belanger Report — *Rapport de la Commission Royale d'Enquête sur la Fiscalité* (Quebec: R. Lefebvre, imprimeur de la Reine, 1965).

²² A further item, s. 5(1)(h) (as amended by S.O. 1971, c. 15, s. 1) was repealed by S.O. 1973, c. 109, s. 1, effective April 13, 1973. It referred to "any non-commutable annuity, income or periodic payment effected in any manner other than by will or testamentary instrument and paid for by the deceased during his lifetime, and paid to and enjoyed by the *spouse* or dependent father or mother or any dependent brother, sister or child of the deceased after the death of the deceased, to the extent of \$1,200.00 per annum in the aggregate". This might have served to exempt many payments made after death pursuant to separation agreements. As will be seen, s. 3(6) dealing with debts of the estate is really the relevant section in this respect.

of her") then divorces her a few years later, and then dies within five years of the disposition. Is the disposition to the person who is now the deceased's ex-wife dutiable at stranger rates or does she have the benefit of the spousal exemption? From what time does the Act speak? The language of the statute is not at all clear; such an occurrence was probably not contemplated by the draftsman. There may be some room for argument. The wife might argue that the section 6(c) reference to "disposition" is controlling: i.e., that the words, "duty shall be levied on *such* person, *with respect to such disposition*" imply that the situation *at the time of the disposition* will determine matters. On the other hand, the Minister would refer to section 7(11)(d)(i) and argue that the words "spouse of the deceased" must be taken together to refer only to such spouse as existed at death, and that the exemption would thus only be available for "dispositions to *such* spouse". It would follow that any dispositions to an ex-spouse would be taxed at stranger rates. The existence of a *new* spouse in this situation would not change the characterization because the exemption only applies to the spouse existing at death. This latter view seems to be the better one, and in fact the Succession Duty Branch of the Ministry of Revenue has informed the author that this is the interpretation that is taken. Some practitioners, however, feel that the situation is needlessly ambiguous and could be clarified.

The same sorts of queries would be raised in a situation where the husband instituted a number of voluntary payments to the spouse before divorce and continued them to the ex-spouse after divorce. Any gratuitous payments *after* divorce would clearly be dutiable (refer to the *Drummond* case,²³ where such a situation arose), but the standard problem arises with respect to the payments made while the recipient *was* actually the spouse. The author's view is that the Succession Duty Branch's approach would probably prevail, but that this is an area where, because of the unusual circumstances involved — particularly the friction of the marital situation — it would seem appropriate to attempt a compromise position, e.g., by exempting the payments made before divorce and taxing those made after divorce. In any case, it seems clear that the wisest course for the practitioner will be to attempt to bring all such payments into the separation agreement and/or divorce settlement — characterize them as debts of the estate — and exclude them from the estate entirely.

Another sort of 5(1)(g) problem might arise in a divorce situation (i.e., the spousal exemption is probably not available) where dispositions were made, say, to the former wife prior to the five year period, but the 5(1)(g) exemption is defeated by "strings attached" in favour of the husband. This is another area where consideration should be given to the succession duty impact on the estranged spouse. (It is a valid assumption that the solicitors on both sides will want to minimize taxes on both parties in order to lessen the hostility that already prevails.) Section 5(1)(g) problems of this nature have received extensive treatment elsewhere. It is enough merely to raise a few possible situations that might defeat the exemption for dispositions made more

²³ *Royal Trust Co., Executors of the Estate of George Arthur Drummond v. M.N.R.*, [1958] 58 D.T.C. 1189 (Exch. Ct.).

than five years prior to death. It is conceivable that in a situation where the former wife has custody of the children, the husband, as part of a "disposition" to her, might insist on the right of directing how, or how much of, the money should be spent on education for the children. In *Estate of Nelson*²⁴ a deceased husband had retained a contingent interest in the trust corpus, dependent upon his survival of the wife's death or remarriage, as well as a joint power to alter or amend the trust. The situation can be especially dangerous if the deceased is a trustee; it appears fairly easy to find a "benefit"²⁵ and it would probably be more so in a family-type situation.

Rates

As noted above the nature of a particular relationship has an important effect on the tax rate (or, indeed, the possible exemption) involved. While transfers to spouses will still be includable in the aggregate value of the estate, the importance of the spousal exemption in section 7(11)(d) cannot be stressed enough in the present context. The tax difficulties involved when the spousal exemption is lost (through divorce) have been pointed out.²⁶ Divorce seems to mean an automatic relegation to the "stranger" category.

Note should be taken of the definitions of "dependant" and "dependent child" in section 7(11). Typically, a great deal depends on the interpretation of the words "spouse of the deceased". Must this refer only to the spouse that existed at death, if any, or can it include *any* spouse of the deceased during his lifetime?

Section 7(11)(d)(i) and (ii) indicate that where a deceased is not survived by a spouse, a larger exemption is available for the child. Thus a prior divorce could lead to a greater exemption for a child. (Significantly, "spouse" was used here, rather than "parent".) Other sections, such as 10(3) and (4) (dealing with insurance and pension funds), and 17b (1)(b) ("family business duty") involve the concepts of "spouse" and "member of the family" of the deceased.

A policy question that might be raised here is why a spouse who was separated from the deceased (and often not a "spouse" at all, in fact) should be given a total exemption when, for example, the children may have relatively little in the way of an exemption. This was the sort of concern expressed by the Ontario Advisory Committee on Succession Duties,²⁷ though it did not direct itself to the particular problem in the marital breakdown context. The same sort of "fairness" considerations should be extended here.

"Debts of the estate" and the problem of consideration

One of the most important matters in the area of estate planning and marital breakdown is the extent to which the transactions and transfers that

²⁴ 47 T.C. 279 (1966).

²⁵ See, e.g., *A.G. v. Cowan*, [1926] S.C.R. 145.

²⁶ A somewhat similar problem in the divorce context occurred in *Estate of Herbert Turner Matson v. M.N.R.*, [1971] Tax A.B.C. 708.

²⁷ *Report of the Ontario Advisory Committee on Succession Duties* (Toronto, 1973) at 20-21.

accompany a separation or divorce settlement can be characterized as debts of the estate and thereby taken out of the assets of the estate. While in some situations the spouse may be entirely exempt from duty anyway, the size of the estate will not be decreased for tax purposes. However this *will* be the result if a payment or transfer is brought into the "debt" category. It is obvious that the planner must be very much concerned with the arrangements and settlements made in the marital negotiations, as these will directly affect estate planning. In this context, family law and tax law cannot be mutually exclusive areas of practice. As one Toronto practitioner pointed out to the author, "Separation agreements are the cheapest form of estate planning".

The relevant section of *The Succession Duty Act* is:

3(6) In determining aggregate value and in determining dutiable value, allowance shall be made for . . . debts and encumbrances incurred or created by the deceased *bona fide* and for full consideration in money or money's worth wholly for his own use and benefit . . ., and all debts and encumbrances for which allowance is made shall be deducted from the value of the land or other subject of property liable thereto . . .

The key words are "for full consideration in money or money's worth". Much of the material that follows relates to the notion of consideration. It will be useful to discuss some of the American developments in this area, for this problem has received extensive treatment in the U.S. courts. As well, the U.K. approach to the problem will be mentioned. There is a scarcity of Canadian (let alone Ontario) cases dealing with the characterization, for death duty purposes, of payments under divorce settlements and separation agreements, so it will be useful to examine the U.S. and U.K. approaches. For the sake of convenience, the gift tax aspects will also be considered here; the problem is essentially the same whether in the gift tax or death duty context: i.e., taking the payment out of the taxable category.

The wording of section 2053(c)(1)(A) of the U.S. *Internal Revenue Code*²⁸ is substantially the same as that found in our section 3(6). It will be useful to trace briefly the U.S. developments.

In the early landmark decision in *Meyer's Estate v. C.I.R.*²⁹ the Court, despite a vigorous dissent by Judge L. Hand, ruled that the amount to be paid to a wife under a separation agreement was includable in her decedent husband's estate for estate tax purposes. In *Helvering v. U.S. Trust Co.*³⁰ the Second Circuit again stated that the wife's right of support was a marital right and not adequate and full consideration in money or money's worth, but it further held that the wife's agreement to support the child of the marriage was adequate and full consideration in money or money's worth, and not a marital right, so that money given by the husband's estate, in return for this, was not taxable under the Estate Tax. A change in approach came as a result of a 1946 Estate Tax Ruling³¹ wherein the Bureau of Internal

²⁸ U.S.C. Annotated, Title 26.

²⁹ 110 F2d 367, cert. denied 310 U.S. 651 (1940).

³⁰ 111 F2d 576 (1940).

³¹ E.T. 19 1946-2 Cum. Bull. 166. See, also, Rev. Rul. 60-160, 1960-1 Cum. Bull. 374, mod'g E.T. 19.

Revenue took the position that the surrender of support rights was not one of the "other marital rights" deemed *not* to be adequate and full consideration in money or money's worth by what is now section 2043(b) of the I.R.C. Since E.T. 19, with respect to transfers made pursuant to legal separation agreements or divorce decrees, for both estate and gift tax purposes, a release of support rights has been deemed to constitute a consideration in money or money's worth *to the extent that the transfer does not exceed the reasonable value of the wife's support rights*. It will be seen how section 7(2) of the Ontario *Gift Tax Act*³² approaches this sensible position, while the situation is by no means made clear in *The Succession Duty Act*.³³

As will also be seen, however, there are some limitations in section 7(2) of the Ontario gift tax legislation, and it is instructive, by way of comparison, to look at section 2516 (which deals only with gift tax) of the U.S. *Internal Revenue Code*. It approaches the problem head on and provides some objective criteria: when a husband and wife enter into a written agreement settling their marital and property rights and a divorce occurs within two years thereafter, whether or not such agreement has been approved by the divorce decree, any transfers made between the spouses pursuant to such agreement, or made for the reasonable support of minor children, are deemed to be made for adequate consideration in money or money's worth, and are not taxable gifts. This may be an admirable model for our own gift tax *and* succession duty legislation. It provides in effect an irrebuttable presumption of "adequate and full consideration in money or money's worth" in the divorce situation. Such a test or some variation thereof may well be preferable to an unrealistic inquiry into the adequacy of consideration. It would be more rational and administratively more convenient.

It is worthwhile to examine briefly some of the positions reached in the U.S. cases, as there are virtually no English or Canadian authorities dealing with these sorts of issues. As noted, the position in the U.S. is that transfers made pursuant to an agreement incident to divorce or legal separation in satisfaction of the wife's right to support would be deemed to be made for an adequate and full consideration. This notion adopts the "depletion" theory rationale; i.e., such a transfer reduces the husband's otherwise taxable estate because he would have had to expend the amount transferred to discharge his support obligation if the transfer were not made.

*Harris v. Commissioner*³⁴ was a landmark U.S. Supreme Court case that established, for purposes of estate duty as well as gift tax, that if a divorce decree approved a property settlement agreement, the amounts were clearly deductible from the gross estate as an involuntary transfer founded on the decree and not on a promise or agreement or surrender of a marital right. There can be little doubt that this result would also be reached in similar circumstances in Ontario.

³² S.O. 1972, c.12, as amended.

³³ *Supra*, note 16.

³⁴ 340 U.S. 106 (1950).

Where a pre-divorce property settlement agreement reserved a contingent reversionary interest to the deceased it was saved from a "pullback" section by virtue of a finding of adequate consideration under the *Harris* rule.³⁵ American courts have found adequate consideration in these situations (arising out of marital breakdowns): the settlement of outstanding *bona fide* indebtedness of one spouse to the other;³⁶ the relinquishment by a wife of property owned by her, such as a partnership interest or shares in the husband's corporation;³⁷ and reasonable payments for the support of the children during minority.³⁸ However, payments in excess of the reasonable value of the minor children's rights to support or payments for adult children are not exempt.³⁹ This is also the result when the husband pays the wife support in excess of the value of her right of support.⁴⁰ The *McKeon* case⁴¹ indicated that there may not be consideration when the wife releases her support right in a separation agreement in return for being given a *trust* income interest, and the problems are compounded when it is an "alimony trust" over which the husband retains too much control. The case of *U.S. v. Past*,⁴² involving the complete dissolution of a community property arrangement, seemed to indicate that the chances of the court finding "full and adequate consideration in money or money's worth" would be increased substantially if business as well as marital rights were involved.

There is a surprising dearth of case law in the U.K. in this area. The following opinions of the general U.K. position are taken from *Green's Death Duties*.⁴³ Unfortunately, no authorities were cited there with respect to the most important propositions.

Where an annuity or an interest under a settlement has been granted *bona fide* in satisfaction of a claim for maintenance on divorce, it is treated in practice as having been made for full consideration for the present purpose [i.e., "property passing by purchase" — exempted by the U.K. legislation]. The practice is applied whether or not the arrangement was sanctioned by the Court . . . and whether or not it purported to limit any right to apply to the Court for maintenance.

(The situation may be different though if the remainderman is a volunteer.)

Provision for the wife in a separation agreement may similarly (subject to the same proviso where the remainderman is a volunteer) be treated as for full con-

³⁵ *Estate of O'Nan*, 47 T.C. 648 (1967).

³⁶ *Estate of Oliver H. P. Johnson*, 2 T.C.M. 208 (1943).

³⁷ *Estate of McCoy*, 20 T.C.M. 224 (1961).

³⁸ *Estate of McKeon*, 25 T.C. 697 (1956).

³⁹ *Harris*, *supra*, note 34.

⁴⁰ *C.I.R. v. Watson*, 216 F2d 941 (1954); *Estate of H. B. Hundley v. C.I.R.*, 52 T.C. 495 (1969), *aff'd* 435 F2d 1311 (4th Cir., 1971). For a good U.S. treatment of what constitutes "adequate support" as opposed to "gift", see David Beck and Sheldon V. Eckman, *Where Does Support End and Taxable Gift Begin?* (1923), N.Y.U. Institute on Federal Taxation 1181.

⁴¹ 25 T.C. 697 (1956).

⁴² 347 F2d 7 (9th Cir., 1965).

⁴³ George Morgan Green, *Green's Death Duties*, ed. D. J. Lawady and E. J. Mann (7th ed. London: Butterworths, 1971) at 265.

sideration, as also provision for children to the extent that the provision is in lieu of maintenance for which the grantor is responsible.

The deductions are allowable where there is a common law liability to maintain. According to this British authority, however, this will not extend to payments made by a wife for the benefit of her husband. (Considering the pattern of social reform, the situation may well be otherwise in Ontario.) Furthermore, the U.K. position seems to be that payments agreed to be made by a putative father in respect of his illegitimate children may also be allowed. Payments agreed to be made to a former mistress are not allowed. A covenant not to molest is not regarded as money's worth for purposes of the debt exemption.

The Canadian authorities dealing with this general problem are very few, but it is vital to examine them, such as they are, in some detail. Stikeman's *Canada Estate Tax Service*, focusing on section 5, the debt section, of the old *Estate Tax Act* notes that payments under a separation agreement are usually allowed to be deducted. But if the agreement goes beyond the matter of separation and includes terms which may be regarded as a post-nuptial settlement, tax could be payable. There may be a good *voluntary* settlement embodied in what *appears* to be a separation deed, "and not the less so because it [is] made on the occasion of separation and the separation [is] the cause and motive of it".⁴⁴

In *Royal Trust Co. v. The King*,⁴⁵ a wife sued in Ontario for a judicial separation, and the action was settled upon her husband agreeing to pay her a monthly sum for the rest of her life. It was held that the monthly sums remaining unpaid at the death of the husband constituted an allowable debt against his estate for provincial succession duty purposes. Here, the wife had abandoned some property rights. The case seems to imply that the result might have been different if the obligation only arose at death. The case also illustrates an interesting approach with respect to the *valuation* of the debt. The court allowed it to be valued for debt purposes (presumably by means of actuarial tables) at the *same* figure as the Government proposed it be valued as a legacy subject to succession duties!

The case of *Royal Trust Company, Executors of the Estate of George Arthur Drummond v. M.N.R.*⁴⁶ raises a number of points, though the result in the case is quite reasonable in view of the principles that have been discussed above. The case involved payments by the husband to his ex-wife *subsequent* to the divorce, and it turned on an interpretation of the debt section of the *Dominion Succession Duty Act*, which is substantially similar to section 3(6) of the Ontario statute. (Significantly, counsel in this case could cite no prior case with similar facts.) Here the deceased *after* the decree entered into an agreement to pay his ex-wife monthly sums for her maintenance

⁴⁴ *In Re Sparks Trust, Spark v. Massey*, [1904] 1 Ch. 451 at 456. (In the author's view, this would seem to be a relatively unusual situation: in *Sparks*, the parties, in fact, had resumed cohabitation later.)

⁴⁵ (1950), 79 Que. S.C. 304.

⁴⁶ *Supra*, note 23.

and support and for the only child. The agreement included a clause that the wife was to bring up the child in a suitable manner. The preamble to the contract stated that the payments were being given to respect and satisfy a natural obligation and to provide for maintenance and/or alimony. The payments were made during the deceased's life and continued by his executors. The executors claimed that the capitalized value of the future maintenance payments was a deductible debt. The argument failed for three reasons: 1) As the deceased was divorced at the time, he was under no legal obligation at that time towards his former wife. There was no consideration. A "natural obligation" is not enforceable in law. 2) The agreement was not tantamount to a contract of hire of the wife's services in bringing up the child.⁴⁷ As a mother, she had her own legal duty towards the child (under the *Civil Code*). Further, she had no power to release the deceased's legal duty towards the child and no covenant to do so could be consideration in money or money's worth. 3) Since the payments were related to income, and since the deceased's personal income ceased when he died, the instructions to the executors to continue making the payments were not based on any legal obligation or debt incurred for "full consideration in money or money's worth for his own benefit or use". There is an obvious implication that the result would have been otherwise if there had been a legal obligation. The case demonstrates more than anything else the vital importance of incorporating such settlements into the divorce decrees or at least into separation agreements beforehand. Obviously such arrangements should never be done by will. The liabilities should be pre-existing and previously established. *Drummond* makes the case for estate planning by way of proper marital settlement management.

*Wurtele, Jarrett and The Royal Trust Company v. M.N.R.*⁴⁸ was another case decided under the *Dominion Succession Duty Act*. Many years earlier, the deceased had been sued for alimony and a settlement had been reached involving seven policies of insurance on his life. The settlement was formalized in a covenant under which the insurance proceeds were to be paid to trustees who would pay a lump sum to the widow outright and keep the remainder invested, with the income therefrom to be paid to the widow for life and, upon her death, the remainder was to be paid to the two children. The Minister contended that the interests of the children in the proceeds of the insurance came to them as "successions" and were dutiable accordingly. The appellants contended that they were not "donees" but rather that their interests arose out of a transaction in which valuable consideration had been given. The court decided in favour of the appellants, holding that their interests had in fact come to them as a result of a transaction in which consideration had been given. In the author's view, the most valuable feature of

⁴⁷ Some *dicta* of Fournier, J. are worth noting. While he dismisses the argument that the wife was under an obligation to bring up the child for the husband, he states at 1193: "But even if it were [a bilateral undertaking with mutual consideration], it does not of necessity follow that the consideration was appreciable in money or money's worth." Whatever one may think of this opinion, it does seem to suggest a possible limitation, as contrasted with some of the U.S. cases dealing with deductions of payments made for child-rearing by the estranged spouse.

⁴⁸ [1963] C.T.C. 167 (Exch. Ct.).

this case is a colourful passage from the judgment of Dumoulin, J. which demonstrates the awareness that one particular Canadian court had of the unique circumstances surrounding a marital breakdown situation with tax consequences. It may be of use to practitioners who find themselves confronted with a claim for tax in similar circumstances.

Unquestionably we are confronted, in this bickering separation deal, with an arm's length transaction, if ever there was one, wherein nothing was given, but everything contentiously liquidated in the bitter atmosphere of matrimonial wreckage. Alarmed, and justifiably so, at the possible loss of her rights as beneficiary, not to mention her children's expectations, Mrs. Wurtele bartered those rights against a \$20,000 payment upon the insured's demise, the receipt during her lifetime of the net annual income derived from the remainder or trust estate, then, as a devoted mother, she *stipulated* the devolution to her son and daughter, at her death, of the trust estate accruing from the insurance fund . . . This understanding of the prompting motives and circumstances of the separation agreement, although unwritten, is clear to anyone possessed of professional experience in that melancholy order of things.⁴⁹

There is no Ontario authority to assist one in knowing what sorts of transactions of this type can be brought under section 3(6) of the Ontario Act. It seems clear that the principles discussed here should, and probably would, apply. The Succession Duty Branch apparently is of the opinion that where transfers occur pursuant to court orders (e.g. divorce, alimony) section 3(6) will apply. When it is a separation agreement situation, the assessors will "look at each on its merits". Hopefully this will mean that the sorts of considerations found in the American cases particularly will be imported into *The Succession Duty Act*.

"Arm's length" transactions

The issue of debts of the estate and valuable consideration having been dealt with, it seems appropriate to make some brief comments about the related notion of "arm's length" transactions. Again, while much of what follows pertains to gift tax legislation as well as succession duty legislation, it is convenient to deal with the matter at this juncture. The concept of "arm's length" dealing is particularly appropriate in the context of marital disruption where transactions that would normally appear to be "non-arm's length" rapidly lose that characterization due to the animosity between the parties. *The Gift Tax Act* includes a definition of "arm's length" that should properly serve to exclude many dealings that occur in the marital breakdown context:

- 2(5) For the purposes of this Act, persons shall be deemed to be dealing at arm's length when each stands upon the strict letter of his rights and conducts his business in a formal manner without trusting to the other's fairness or integrity and without being subject to the other's control or over-mastering influence.

By section 5(2) an arm's length transaction is deemed not to confer a benefit on the party involved. These sections might come into play with respect to a marital settlement that for some reason does not fall into the section 7(2) category.⁵⁰

⁴⁹ *Id.* at 172.

⁵⁰ See Part V, *infra*.

It would seem desirable to have such provisions in *The Succession Duty Act* as well.

It would not seem too outrageous to go one step further, as the American courts have done at times, and state unequivocally that actual consideration is *irrelevant* in a marital disruption situation where the parties are so hostile as to be dealing at arm's length by necessity. This seems to have been the U.S. Supreme Court's outlook in *U.S. v. Davis*.⁵¹ The courts should recognize that when a settlement is made in contemplation of divorce, the parties are usually hostile and bargaining at arm's length. Under these circumstances there is little danger that a claim against the deceased's estate is being relinquished merely to obtain a more advantageous distribution of property. The relinquishment of rights is bargained for and clearly has money's worth value to the deceased.

On the other hand it could be argued that there are many gradations of hostility along the marital breakdown spectrum. As professor Gower warns (rightly or wrongly), "they rarely contract at arm's length until their fists fly".⁵² And in *Estate of Glen*⁵³ the majority emphasized that the hostile atmosphere generally pervading divorce property settlements necessitated a subjective inquiry into whether the particular relationship was nearer the "romantic waltz" or "violent Apache dance" ends of the continuum.

V. THE GIFT TAX ACT

Several sections of *The Gift Tax Act*⁵⁴ have been referred to in the course of the discussion. It is proposed at this juncture to deal very briefly with some issues raised by other sections of the Act.

For our present purposes, a very key section is 10(1)(g) which provides for an exemption from tax for "an absolute and indefeasible gift, except a gift made by the creation of a settlement or the transfer of property to a trust, made by the donor to his *spouse*". Once again, the concept of "spouse" is crucial. (It will be noted that the definition of "spouse" in section 1(24) "includes" a common law wife or common law husband. Reference may be had to the definition of "common law spouse" in 1(5).) Section 10(1)(g) clearly implies that the donee must be the spouse of the donor at the time of the gift. The fact that a divorce occurs later would not matter, presumably. Of course, once one loses his spouse through divorce, the estate planning techniques available to him will be limited. Devices in the nature of "double-gifting", for example, will no longer be feasible. Section 10(1)(g) does not exempt gifts to a trust for a spouse.⁵⁵ This may well be important in the context of marital settlements.

⁵¹ 370 U.S. 65 (1962).

⁵² L.C.B. Gower, letter to the editor (1970), 120 New Law J. 1072.

⁵³ *Supra*, note 7.

⁵⁴ *Supra*, note 32.

⁵⁵ See the Advisory Committee on Succession Duties, *supra*, note 27, which recommended at 40-41 that there be an exemption here.

Reference should be made to the definition of "disposition" (s.1(8)), "gift" (s. 1(12)), "settlement" (s.1(22)) and the section dealing with "deemed gifts" (s. 3), for these may come into play in the present context. In addition, the following should be noted:

2(1) For the purposes of this Act,

- (b) persons are connected by marriage if one *is married* to the other or to a person who is connected by blood relationship to the other; and
- (c) persons are connected by adoption if one has been adopted as the child of the other or as the child of a person who is so connected by blood relationship (other than as a brother or sister) to the other.

Needless to say, the most important provision in *The Gift Tax Act* for our present purposes is section 7(2) — perhaps the only specific attempt in the legislation to provide for the consequences of marital disruption.

- 7(2) An amount paid by an individual to his spouse who is living apart from the individual, or his former spouse, as or toward the maintenance of the spouse or former spouse shall be deemed not to be a gift to the spouse or former spouse if the amount is not excessive, having regard to the legal and moral obligations of a person to his spouse or former spouse, notwithstanding that the individual was not under any legal obligation to pay the amount.

This section raises several points. It can be seen to be broader than the U.S. *Code's* section 2516 noted above⁵⁶ that is, not as circumscribed by conditions. However it is clearly more subjective in nature. The attempt to introduce the measuring stick of "legal and *moral* obligations" — whatever they may be — seems remarkable in the context of a taxing statute. Section 7(2) would cover alimony payments to the spouse, payments made to the spouse under separation agreements and maintenance payments to the former spouse under divorce settlements; however it does not refer specifically to payments directed to the maintenance of children. It should be noted that the donor need not be "under any legal obligation to pay the amount". Thus it would seem that in a *Drummond* type situation the gratuitous payments made *after* divorce and before death could be *exempt* from gift tax by virtue of section 7(2)!

The key to section 7(2) may lie in the words "if the amount is not excessive". This sort of consideration was a theme in some of the U.S. cases already discussed. A so-called "anything for freedom" payment might well be "excessive". Presumably, though, if the gift is deemed excessive by virtue of the rather subjective criteria outlined in section 7(2), the donor could attempt to rely on section 10(1)(g) (if the donee was still his spouse), or could try to argue that the dealing was at arm's length and/or for valuable consideration. (In this connection reference might be made to sections 3(b), 7(3) and (4).)

⁵⁶ See text following footnote 33.

One major issue with respect to section 7(2) is the meaning of the word "amount". The word is defined in section 1(2) and seems fairly broad in scope. Indeed, some practitioners feel that such a definition (similar to that in the *Income Tax Act*) could thus include almost anything. However it is necessary to look at the surrounding words in the subsection; and it would seem that the words "amount paid", taken together, would serve to *limit* the type of transfers contemplated to payments of *money* pursuant to marital settlement arrangements. The subsection probably does not encompass transfers of real estate, for example, and to this significant extent, the operation of 7(2) is limited in scope. However, section 10(1)(g), if applicable, may well be the answer, as it is certainly not limited to money payments.

At this juncture it might be worthwhile to make some comments with respect to the use of *inter vivos* trusts in the marital breakdown context. As will be seen, gift tax considerations can come into play. In a post-divorce situation where one parent has custody of children, there can be problems when money assets are put into a trust for their benefit: the donor loses control of the money except to the extent that he has control of the trustee; there is attribution of income to the donor (section 75, *Income Tax Act*); and unless it complies with *The Gift Tax Act* (section 11(2)), gift tax will be payable.⁵⁷ As noted, there is no gift tax exemption for any amount of money given to a trust if it is for the benefit of a spouse; it must be given outright. Moreover, there is no exemption for any money given to a trust for the benefit of a child unless there is only one beneficiary and it becomes absolutely vested in him by age forty. Thus there will usually be gift tax liability in the situation of a mixed trust for a number of children.

One Toronto practitioner⁵⁸ has described an unfortunate situation where monies were placed in a trust fund (with lawyers as trustees and a trust company as custodian and distributor of cash). The husband, having custody of the children, succeeded in eroding the trust by demanding money for support of the children "otherwise he would kick them out at age 18". Obviously there is a need for controls so as to prevent the plundering of a trust. As well, in this area particularly, care must be taken in selecting trustees and stipulating who has power to change trustees. Some practitioners are of opinion that the separation agreement itself should not be the trust document; the trust agreement should be a separate document — perhaps with the separation agreement scheduled to it for the benefit of the trustee.

VI. TRANSFERS OF CAPITAL PROPERTY: THE INCOME TAX ACT

The *Income Tax Act* contains several provisions relating to marital disruption, but these deal primarily with *income* aspects. It is proposed to exa-

⁵⁷ See Robson, *supra*, note 3.

⁵⁸ *Id.*

amine briefly only some sections that might be taken into consideration in an estate planning context.⁵⁹

The *Income Tax Act* now contains provisions respecting the taxation of capital gains. It is not proposed to examine the details and mechanics of computing capital gains liability here. Suffice it to say that while section 70(5) provides for a deemed disposition of capital property on death, section 70(6) in effect provides for a "rollover" when assets are transferred to a spouse or spousal trust. Specifically,

- 70(6) Where any property of a taxpayer who was resident in Canada immediately before his death that is property to which paragraphs (5) (a) and (c) or paragraphs (5) (b) and (d), as the case may be, would otherwise apply has, on or after his death and as a consequence thereof, been transferred to
- (a) his spouse who was resident in Canada immediately before the taxpayer's death, or
 - (b) a trust, created by the taxpayer's will, that was resident in Canada immediately after the taxpayer's death and under which
 - (i) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and
 - (ii) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust,

if the property can, within 15 months after the death of the taxpayer or such longer period as is reasonable in the circumstances, be established to have become vested indefeasibly in the spouse or trust, as the case may be, not later than 15 months after the death of the taxpayer, [the rollover is available].

In this particular statutory context, it seems clear that "spouse" refers to such spouse as exists at the taxpayer's death; however there may be some room for doubts of the sort expressed in the discussion of *The Succession Duty Act*. In a situation where property has been left to a former spouse, since divorced, and the will has not been changed, it would seem that there would be a deemed disposition under section 70(5). If the taxpayer had remarried and the second wife survived him, it would seem that section 70(6) would be operative with respect to transfers in favour of the new wife, if all other conditions were met. Similarly, if the taxpayer was merely separated from his wife at the time of death, he would still have a "spouse" for purposes of section 70(6).

⁵⁹ It is interesting to note that the Carter Commission — *Canada, Report of the Royal Commission on Taxation*, Vol. 3 dealt specifically with marital disruptions as part of the discussion of the "family unit" concept at 129ff., 139. Its proposals were as follows:

3. On the divorce or legal separation of the spouses the family unit would terminate, but there would be no tax consequences. To be specific, we note the following:
 - (a) There would be no deemed realization of property gains to the dissolved family unit except with respect to property passing to third parties;
 - (b) The two new tax units created by the dissolution of the old family unit would not be required to bring property taken from the old unit into income regardless of which spouse originally held the property.
- A divorced or separated spouse who retained custody of one or more dependent children would form a new family unit with those children.

It should be noted with respect to section 70(6) that a remarriage clause, sprinkler or discretionary income provisions will taint the transaction and result in a disqualification. A remarriage clause, for example, would mean that the spouse was no longer entitled to receive all the income of the trust till her death. A testator must therefore take his chances on the wife not remarrying if he wishes to retain the rollover advantage.

A reasonably common occurrence is the transfer of property between spouses prior to, and in anticipation of, divorce. This might involve shares in a private company, for example. Accordingly, section 73 of the *Income Tax Act*, dealing with *inter vivos* transfers of capital property, will be important from a practitioner's point of view.

73(1) For the purposes of this Part, where at any time after 1971 any particular capital property has been transferred by a taxpayer to his spouse, or to a trust created by him under which

(a) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and

(b) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust,

and both the taxpayer and the spouse or trust, as the case may be, were resident in Canada at that time, [a rollover is available].⁶⁰

Certain points are raised by section 73. Obviously if the taxpayer were divorced at the time of the transfer (say, to the ex-wife) there would be no rollover. The benefit would not be available in the case of a common law partner. There *would* be a rollover if the taxpayer were merely separated from his wife, the transferee. If a divorce occurred *after* the transfer, nothing in the Act seems to prevent the section from operating. If the transfer occurred as part of a settlement under the divorce decree, it appears quite possible that a disposition would occur since the parties have ceased to be spouses. Thus, in the interests of certainty, if a rollover is desired in the particular situation, it is imperative that the property be transferred before divorce, i.e. while the parties are still married — perhaps in the separation agreement.

Reference should be made once again to the ways in which a spousal trust may be tainted. In the section 73 context it should be pointed out that an attempt to include a provision for the property reverting back to the husband on divorce would probably have the same result. As a final matter, it should be noted that, as in the case of transfers at death, no rollover is available in a situation involving trusts for children.

Section 104(4) provides that if a spousal trust is created during the lifetime of the transferor or by his will, a deemed disposition will not occur until the transferee spouse dies. Of course, in the context of marital breakdown, it may well be that the transferee wife does not want the rollover, i.e. the deferral of tax till her death. While the rollover may be beneficial for the transferor, it could be different for the other parties involved. On the other hand,

⁶⁰ This section eliminates some of the concern that was felt, e.g., in the U.S. after *U.S. v. Davis*, *supra*, note 51, where it was held that a transfer of appreciated property to a spouse in such circumstances is a taxable event and the gain must be recognized.

the deferral of tax might free more funds for distribution as part of the impending marital settlement. Clearly, the rollover aspect should be one element to be considered in the negotiations.

In this regard, reference should be made as well to the provision for attribution of income:

- 74(1) Where a person has, on or after August 1, 1917, transferred property either directly or indirectly by means of a trust or by any other means whatever to his spouse, or to a person who has since become his spouse, the income for a taxation year from the property or from property substituted therefor shall, during the lifetime of the transferor while he is resident in Canada *and the transferee is his spouse*, be deemed to be the income of the transferor and not of the transferee.

It thus appears that there would no longer be any attribution of income after the spouses had divorced.

Furthermore, section 40(4) provides that if a principal residence is transferred in a section 70(6) or 73(1) situation, the spouse to whom it is transferred is deemed to have owned the property throughout the period during which the taxpayer owned it, and it is deemed to have been that spouse's principal residence for any taxation year for which it was the taxpayer's principal residence or would, if the taxpayer had designated it to have been his principal residence for that year, have been the taxpayer's principal residence.

One section of the *Income Tax Act* contemplates the possibility of marital breakdown. According to section 108(1)(g), "preferred beneficiary" under any trust means an individual resident in Canada who is a beneficiary under the trust and is

- (ii) the spouse or former spouse of the settlor of the trust.

Sections noted above have demonstrated the advantages accruing to a taxpayer who has a spouse. One might mention the similar sorts of advantages derived from such devices as "his and hers" Registered Retirement Savings Plans and Registered Home Ownership Savings Plans. Of course, the attendant dangers of tying up one's funds in these sorts of schemes when the marital situation is uncertain must also be appreciated.

VII. REAL ESTATE

When a potential marital breakdown situation arises, the first thing that the party involved considers (aside from changing his will) is the problem of getting his assets out of joint ownership. Often a problem arises when the matrimonial home (or, indeed, other property) is held in a joint tenancy. Once the marriage breakdown commences, the matter of joint ownership can only be resolved through negotiation (often culminating in partition). In view of this, a high premium is placed on making the right decisions, with respect to the holding of title to land, *prior* to marital disruption. Some situations are obvious: If a husband, separated from his wife, is buying property, he certainly would not consider joint ownership and probably would take "to uses" to defeat any dower interest.

Often there occurs a sale of an interest in jointly held land pursuant to a separation agreement. The Land Transfer Tax Branch in Ontario has apparently devised a policy whereby in a situation where no separate consideration is allocated to the interest in the real property being conveyed, one-half of the value of the real property at the date of the agreement be declared in the Affidavit of Land Transfer Tax (which would recite the separation agreement) as the true consideration for purposes of calculation of that tax. It could not be nominal; it was hardly given for "natural love and affection"! In such a sale of interest situation, attention must be drawn to such matters as obtaining transfers of fire insurance and the like. In addition, subsearches of title would be essential in this context.

The Ontario *Land Speculation Tax Act* has added a new dimension, and it is well to touch briefly on a few matters raised by the legislation and by the Ontario Bar's Brief to the Government respecting the Act.⁶¹ Section 1(1)(e) of the Act provides that no proceeds of disposition arise on a disposition under the will of any person or on the intestacy of any person. This seems to obviate a lot of difficulties; however the Brief points out⁶² that the provision is ambiguous (for example with respect to transfers of land from a personal representative to a beneficiary), and in addition fails to provide expressly for a rollover in the case of a death of a joint tenant. The Brief also recommends a further exemption when land is transferred from one spouse to another:

An interspousal transfer of property has come to be recognized as a transaction which should not give rise to tax. This is reflected in the federal *Income Tax* and the provincial *Gift Tax Act*. There would appear to be no reason for imposing a tax on an interspousal transfer under this Act. The transferee spouse should take the land at the adjusted value of the transferor at the date of disposition, and any applicable exemptions should also flow through to the transferee spouse.⁶³

This would bring into play the sort of "settlement planning" discussed previously.

Sections 4(e) and (f) of the Act provide that a person can convey the family home and cottage without attracting tax. The Brief proposes that this exemption "be extended to allow a transferor who owns and maintains a residence *for the use of his spouse with whom he is not living* to claim an exemption for the property provided that he is living apart from his spouse" (emphasis added).⁶⁴ In the present Act, the exemption is only open with respect to a property *inhabited by the transferor*. Thus if the owner purports to sell the family home which is currently inhabited only by his wife under a separation agreement, for example, the transaction could attract tax. (Note that if it were disposed of by will, there would be no tax.)

As a final point, it may be noted that the Brief also recommends⁶⁵ that the Act provide for an exemption for the disposition of a residence which has been held in a spousal trust.

⁶¹ The Law Society of Upper Canada and the Ontario Branch of the C.B.A., *Brief to the Government of Ontario on the Land Speculation Tax Act, 1974*.

⁶² *Id.*, at 15, 24.

⁶³ *Id.* at 24.

⁶⁴ *Id.* at 26.

⁶⁵ *Id.* at 27.

VIII. SOME MATRIMONIAL PROPERTY ASPECTS

In part, this study is concerned with identifying the nature of the interests of parties and then determining what tax consequences flow therefrom. However in the context of disputes over rights to the matrimonial home, courts have sometimes reversed this process and looked to tax considerations as one factor — albeit a minor one — determining the extent of a party's interest. In the landmark case of *Pettitt v. Pettitt*, Lord Upjohn was aware of the role of estate planning.⁶⁶ The intention to reduce potential estate duty liability was regarded as relevant (without much weight being attached to it) in *Bedson v. Bedson*⁶⁷ and *Wilson v. Wilson*.⁶⁸ In *Heseltine v. Heseltine*⁶⁹ the fact that the wife had hoped to save a large amount of estate duty by transferring property to her husband did not prevent her reasserting a claim to the property on breakdown of the marriage.

However, the more important issue for our purposes is in fact the tax implications that result from the current treatment of interests in the matrimonial home at common law and in equity. In this area of property in the matrimonial home, the tax planner must be concerned with the current debate — in and out of the courts — with respect to the relative interests of the spouses. This issue will have implications for the size of the estate. It is difficult to determine the extent of property that passes on death when the extent of the deceased's beneficial interest in the matrimonial home may be unclear. Recent cases indicate that the legal title is by no means determinative. Furthermore, when property rights have been carved out of the matrimonial home by the court in favour of the wife, it is not at all clear whether the husband should be regarded as having made a disposition, or an involuntary transfer by operation of law. The puzzle has really not been grappled with to any significant extent.⁷⁰

The tax adviser's job is complicated by the fact that he cannot rely solely on the legal title, but must also look to the extent and type of contribution which a spouse makes to the household — in cash and in kind, direct or indirect — and the existence of any agreement as to the effect of the contribution. In a situation where a wife contributes one-tenth of the purchase price, but a court would consider that she is entitled to a half-interest on the basis of other criteria, there could be significant consequences for the estate involved. The cases often speak in terms of one spouse holding part of the matrimonial home "in trust" for the other. And as Easson⁷¹ has pointed out, one must be concerned not only with property held in the name of the de-

⁶⁶ [1969] 2 All E.R. 385 at 409 (H.L.).

⁶⁷ [1965] 2 Q.B. 666.

⁶⁸ [1963] 1 W.L.R. 601. See, also *Hine v. Hine*, [1962] 3 All E.R. 345.

⁶⁹ [1971] 1 All E.R. 952 at 955 (C.A.).

⁷⁰ In New Zealand, the settlement of a home under the *Joint Family Homes Act* (N.Z.S. 1964, No. 45) is deemed not to be a gift within the meaning of the *Estate and Gift Duties Act* (N.Z.S. 1968, No. 35), perhaps implying that apart from the express provision, it would be treated as a gift.

⁷¹ *Supra*, note 4.

ceased, in which some other person may have had an interest, but also with property held in *someone else's* name in which the *deceased* may have an interest. For example if the deceased had an interest in a house which was conveyed into the sole name of the surviving spouse, he may well still retain an interest on the basis of substantial improvements made and paid for by him. Accordingly, the tax planner should see that clear evidence of the intention of the parties is provided in the dealings, to ensure that a transaction has the effect it is intended to have. When advising clients as to the most desirable method, from a tax viewpoint, of holding the matrimonial home, it may be prudent to point out that subsequent actions (such as making mortgage payments, or improvements) may alter the position.

It is said that marital property reform by statute will provide more certainty (i.e. obviate the necessity to cite family cases in estate duty actions). For this and other reasons, it is worthwhile touching on the proposed Ontario reforms. This is certainly a topic in itself and no attempt will be made here to do anything but point out some issues raised in the debate.

The proposed Marital Property Regime (MPR)⁷² is a form of deferred community of property in which the spouses would remain separate as to property during the currency of marriage, each having control and management of his or her own assets. Assets acquired during marriage would be common property. The regime would terminate on death, court proceedings at divorce, or on an application by one spouse for winding up when the spouses have been separated and living apart for at least a year and normal cohabitation has terminated. A person subject to the MPR who makes a testamentary disposition in favour of a spouse would be taken to have intended to confer a benefit in addition to the "equalizing claim" payable at death or dissolution. Each spouse would have a *prima facie* right to an equal share in the matrimonial home. The surviving spouse would be able to apply to the court for an extension of occupational rights in the home, in the face of a testamentary disposition by the deceased spouse of his half-interest in favour of another beneficiary. What happens to that beneficiary's interest in such situations is not made clear.

The result of such a scheme may be that the situation respecting interests in matrimonial homes is clarified. However some anomalies could result. Where a couple opt for separation of property and the husband voluntarily conveys the house into their joint names prior to death, the interest conveyed could be brought into the estate. However it could well be deductible if the same thing were allowed to be done by operation of the proposed new law.

One Toronto practitioner is of the opinion that the size of the estates would be reduced under the proposed MPR because large portions would take on the nature of legal obligations ("debt", in essence) by virtue of the "equalizing claim". This seems to be the position in the U.S. in states where an equal division of community property occurs.

⁷² Refer to Ontario Law Reform Commission, *Report on Family Law, Part IV: Family Property Law* (Toronto: Ont. Dept. of the Attorney General, 1974), especially Ch. 5, Rec. 5 at 55ff.

Another practitioner⁷³ points out that life insurance apparently would not be brought into the MPR despite its importance in estate planning and family arrangements generally. Further, it is said — rightly, in the author's view — that “a matrimonial property regime may be inappropriate where there have been several marriages, and especially where there are children of earlier marriages to whom the parent feels a responsibility that the spouse does not share”.⁷⁴ In such cases, there is a distinct possibility that one would opt out of the MPR.

IX. LIFE INSURANCE

Needless to say, life insurance is important in estate planning, if for no other reason than that it often constitutes a major portion of the estate. In the context of marital breakdown, insurance has advantages for settlement purposes because it does not carry with it the emotional attachment that may surround other family assets. The parties may well approach life insurance more objectively, as a mechanism for reaching settlement.

Initially, it is desirable to take note of the legal position with respect to the designation of beneficiaries. It is well settled that where an insured designates his wife as a beneficiary and then a subsequent separation agreement (or divorce settlement) is silent as to the policy, the wife (or ex-wife) is entitled to the proceeds of the policy.⁷⁵ Obviously a person in marital difficulties should give thought to changing the beneficiary designation under his policy if this is possible. Until the 1962 amendments to *The Insurance Act*,⁷⁶ there existed specific sections dealing with divorce and separation. For example, on divorce, all interest would pass to the insured or his estate.⁷⁷ This is no longer the law, though it would seem infinitely more desirable to have some reasonable statutory presumptions of this sort, e.g. to the effect that divorce would remove an ex-spouse as beneficiary under an insurance policy (or, for that matter, revoke a will in favour of the ex-wife).

Section 168 of the present Act does provide that where a beneficiary predeceases the life insured and no disposition of the share of the deceased beneficiary is provided in the contract, the share is payable to the insured or his personal representative. This provides some comfort for an insured when his estranged spouse has predeceased and he had previously forgotten to change the beneficiary designation or was precluded from doing so.

Since July 1, 1962, section 165 or its equivalent has provided for “irre-

⁷³ See Wolfe D. Goodman, *A Critique of Family Property Reform* (1974), 1 Estates and Trusts Quarterly 315.

⁷⁴ *Id.* at 320.

⁷⁵ *Armstrong v. Imperial Bank of Canada*, [1938] O.R. 239, [1938] 2 D.L.R. 680 (Ont. S.C.); *Re Pierce*, [1952] O.R. 828, [1952] 4 D.L.R. 791 (Ont. H.C.); *Re Cadieux* (1929), 37 O.W.N. 184. In *Gerhard v. Travellers Insurance Co.*, 258 A.2d 724, the result was the same even though a separation agreement stated that neither would make claims on the other's estate, and purported to waive all claims.

⁷⁶ R.S.O. 1960, c. 190.

⁷⁷ *Id.* ss. 175, 176. This seems to be the position in Quebec: see *Winer v. Great-West Life Assurance Co.*, [1941] 8 I.L.R. 286.

vocable beneficiaries". If the life insured names some person irrevocably to be his beneficiary he can never change it without the written consent of that beneficiary. Thus if the estranged spouse happens to have been designated an irrevocable beneficiary, another item will be added to the list of matters to be negotiated in the settlement.

Since July 1, 1962 there has no longer been a "preferred beneficiary" class. However under section 146(3) of the Act this concept may still come into play if the contract of life insurance was entered into before that date. And this can create problems in the context of marital disruptions.⁷⁸

As part of a separation agreement or divorce settlement under which the husband is obligated to make support payments to the wife, it may be desirable for the wife to retain the benefit of a policy on the husband's life in order to protect her interest in future support. The wife (or ex-wife) in this example may wish to take out a completely new policy of her own on the spouse's life, and stipulate that her support payments be increased to cover the cost of the premiums. There would seem to be no problem as regards an insurable interest after separation or divorce, since by section 153 of *The Insurance Act* it is possible to insure one "upon whom [s]he is wholly or in part dependent, for, or from whom [s]he is receiving, support or education" or any other person "in the duration of whose life [s]he has a pecuniary interest".

However, because of the age of the spouse, for example, it may not be possible to obtain a new policy. Accordingly, she may wish the existing policy to be transferred to her under the settlement so that she can ensure that the premiums are paid and the policy won't lapse. Presumably she would still insist on her support payments being increased to cover the cost of the premiums. The *control* factor seems an important one, especially when there are minor children involved.

The value of the other rights associated with the policy, such as borrowing rights, might be reflected in the settlement entered into. A comprehensive property settlement might stipulate which party is to have what benefits from the policy.⁷⁹

Of course the insured husband may well have interests in the policy that would necessitate tactful bargaining on both sides. The husband may wish to insert a form of "*dum casta*" clause into the settlement such that the policy would lapse or the wife's interest thereunder would cease if she remarried. Or the husband may contemplate remarriage himself and, to the extent that the new wife needs protection, would want to *retain* maximum flexibility in the beneficiary designation, especially since it becomes increasingly difficult to

⁷⁸ For an illustration of some problems involving divorce and preferred beneficiaries, see *Re Cadieux, supra*, note 75. Where a divorced man remarries a person previously named as a beneficiary under a contract of insurance entered into prior to his divorce, such person becomes a preferred beneficiary: *Re McEwan*, [1945] O.R. 575, [1945] 4 D.L.R. 207 (C.A.). See, also, *Re Collins* (1931), 40 O.W.N. 399 (H.C.).

⁷⁹ See Richard P. Smith, *The Effect of Divorce on Life Insurance Policies* (1970), 46 North Dakota Law R. 417, for discussion of this point, and specimen clauses.

obtain insurance as one advances in years. If the former spouse was designated an irrevocable beneficiary, the husband will have to bargain.

The parties will of course be interested in the succession duty implications of the insurance settlement. If the insured husband should die, the percentage of the insurance proceeds that corresponds to the percentage of the premiums paid by the deceased will form part of the estate. If the beneficiary is still his spouse (as in a separation situation) she will be exempt from succession duty but the size of the estate will still be affected. In a divorce situation, she would probably not be exempt. In any case, it would seem desirable for the wife (or ex-wife) to begin making the premium payments out of her own funds from the time of the marital settlement. In a divorce situation, the question of whether the estate or the surviving party is to be responsible for succession duties would have to be a matter for negotiation. The separation agreement could provide for the insertion of a relevant clause in the insured's will.

X. ADOPTED CHILDREN AND STEPCHILDREN

Sections of the study have made reference to the position of adopted children and stepchildren with respect to the tax statutes. A few points remain to be discussed.

It will be noted that s. 83 of *The Child Welfare Act*⁸⁰ provides that an adopted child "for all purposes" becomes the child of the adopting parent "as if the adopted child had been born in lawful wedlock to the adopting parent". Other sections are worth quoting *verbatim*:

84. In any will or other document, whether heretofore or hereafter made, unless the contrary is expressed, a reference to a person or group or class of persons described in terms of relationship by blood or marriage to another person shall be deemed to refer to or include, as the case may be, a person who comes within the description as a result of his own adoption or the adoption of another person.
85. An adoption effected according to the law of any other province or territory of Canada or of any other country, or part thereof, before or after the commencement of this section, has the same effect in Ontario as an adoption under this Act.⁸⁰

Section 84, added to the Act in 1965, would appear to lump adopted children in with natural children if the provision in the will is broad and general. There is dispute as to whether the section should operate to "alter" the wills of testators who were not alive at the time of the amendment. The preferred view would seem to be that of Galligan, J. in *Re Barthelmes*:

I think it was probably in the mind of the legislature, at the time it enacted s. 84, that in individual cases that section may have the effect of making changes in wills the makers of which were dead at the time that amendment to *The Child Welfare Act* was made.⁸¹

In any case, with the passage of time, the dispute over applicability will cease to be of any practical importance.

⁸⁰ R.S.O. 1970, c. 64.

⁸¹ [1973] 1 O.R. 752 at 754.

It should be borne in mind that if a person does not adopt his stepchildren, they will not be his "children" for most purposes (unless a particular statute — such as *The Succession Duty Act* deems otherwise for its particular purposes). And of course the stepchildren may be too old for adoption in any case, and accordingly would not come within a bequest to "children".

XI. THE DEPENDANTS' RELIEF ACT

One typical response of a spouse embroiled in marital problems is to cut the other spouse out of his will entirely. In such a situation *The Dependants' Relief Act*⁸² could come into play. Section 2(1) provides that "where it is made to appear to the judge of the surrogate court of the county or district in which a testator was domiciled at the time of death that the testator has by will so disposed of real or personal property that adequate provision has not been made for the future maintenance of his dependants or any of them, the judge may make an order charging the whole or any portion of the estate, in such proportion and in such manner as to him seems proper, with payment of an allowance sufficient to provide such maintenance". "Dependant" is defined by the Act as "the wife or husband of a testator, the child of a testator under the age of sixteen years or the child of a testator over that age who through illness or infirmity is unable to earn a livelihood". The "allowance" may be "an annual payment or otherwise, or lump sum or conveyance or assignment of property, either absolutely or for life or for a term of years". As a result of an amendment⁸³ that came into force on December 4, 1973, provision is now made for interim orders and variation of orders due to changes in circumstances (rather similar to the *Divorce Act*).

It is obvious that a practitioner should avoid constructing a complex (or for that matter, any) estate plan in a will if there is a chance that it may be defeated by the dependants' relief legislation.

Section 9 provides that the Act shall not operate in favour of a wife who "was living apart from her husband at the time of his death under circumstances that would disentitle her to alimony". This could be very important in a situation where husband and wife have separated and the husband, say, has made no provision for his wife in his will prior to his death. If there is no separation agreement, it would be necessary to examine the law pertaining to alimony to determine whether the Act would apply. In the more usual case of a separation agreement, there may be an element of uncertainty. It is commonly thought that the existence of a separation agreement usually disentitles a wife to alimony. Indeed, in *Olin v. Perrin*⁸⁴, where a lump sum payment was made to the wife under an agreement whereby she accepted it as a total discharge of all obligations, the effect was to bar forever her right to alimony. She had "contracted out", in effect. However, in *Re Carey*,⁸⁵ where periodic payments were made under a separation agreement, the court likened the

⁸² *Supra*, note 5.

⁸³ S.O. 1973, c. 131.

⁸⁴ [1946] O.R. 54 (C.A.).

⁸⁵ [1940] O.R. 171 (C.A.).

amounts to alimony payments and declared that the right to actual alimony was not forfeited but was merely "in suspense" until such time as the agreement was breached. It should be noted that the facts are different in these two cases and the problem could be resolved accordingly. Yet it would seem that public policy considerations should properly determine the matter, for what is involved here is a "contracting out" of statutory safeguards.

For the sake of completeness, it should be pointed out in this regard that it is reasonably common for a husband, who is so inclined, to use a revocable *inter vivos* trust to avoid the implications of *The Dependants' Relief Act*. The Act applies only to the operation of wills; accordingly, the husband will take most of the assets out of the estate leaving only a small amount available for the wife. Robson⁸⁶ describes a scheme where most of the husband's assets were placed in a revocable *inter vivos* trust of which his mistress and some friends were the trustees. All of the estate — such as it was — was left to his wife (precluding an application under the Act) and the mistress was named the executrix. Such schemes might be labelled the "wife avoidance" (as opposed to "tax avoidance") kind of estate planning! It would not be unreasonable to expect statutory reform in this area.

An order under *The Dependants' Relief Act* will have succession duty implications. Section 19 of *The Succession Duty Act* provides that

19. Where an order is made under section 2 of *The Dependants' Relief Act*, the deceased shall be deemed by his will to have directed that the money or other property directed by the order to be paid, delivered, transferred, conveyed or assigned, be paid, delivered, transferred, conveyed or assigned to the person for whose maintenance the allowance is by the order made.

Thus the "dependants", or some of them, may take a larger portion of the estate and the exemption provisions will apply accordingly. The wording of section 19 does not seem to leave any scope for treating the allowance under the order as a debt of the estate (since it is deemed to be made by his will), though there are indications that the Succession Duty Branch may be willing to regard it as such.

One minor point remains: It would seem difficult for executors, who by section 4(3) of *The Dependants' Relief Act* are directed to pay succession duties prior to the application if necessary, to estimate the proper amount of duty in advance of the actual order altering the will.

XII. WILL DRAFTING AND THE WILLS ACT

This final section of the study deals with purely non-tax aspects of estate planning in a marital breakdown setting. It is proposed to list some useful provisions for the will drafter, and also to note some particular areas of wills law that may be important in this area, if for no other reason than that they serve to dispel some myths.

Previous sections have referred to some possible provisions in settlement agreements and wills. It should be noted that a comprehensive separation

⁸⁶ *Supra*, note 3.

agreement and/or divorce settlement may stipulate what is to be covered in the parties' wills (for example, provisions for the children of the marriage).

The will itself might refer to the separation agreement and provide directions to the executors with respect to the making of support payments.

If a divorced wife has custody of the children there will be a question as to who is to be named as executor. Preferably someone who gets along well with the children — such as a relative — will be appointed. The practitioner may want to inquire as to whether the spouse's new partner is adequate for this purpose. The parent who does not have custody may want to benefit his children, without putting the money into the hands of the custodial parent. In such a situation he must rely on his executor for this purpose. Finally, it should be noted that the appointment of a guardian by will has no legal effect.

What happens when a will is not changed and a divorce occurs prior to death? Nothing in *The Wills Act*⁸⁷ specifically deals with the problem. Section 21 provides that no will is revoked by any presumption of an intention on the ground of an alteration in circumstances. If a divorce occurs and the will (in favour of the named former wife) is not changed though the former wife has entered into a property settlement, without specific language to the contrary such a settlement would not disable her from taking under her ex-husband's will.

However, if the husband has remarried in such a situation, the will would be revoked by section 20. To this extent, the problem would be remedied. The provisions of *The Devolution of Estates Act*,⁸⁸ dealing with intestacies would be operative. Section 20 would also be important in a situation where, after a divorce, the husband alters the will making no provision for a wife at all, but then remarries and forgets to make provision for the new wife. The intestacy legislation would then come into play.

It should be noted that when a will is revoked by operation of law in such circumstances, *The Insurance Act* provides that this has the effect of revoking a designation made by that will.⁸⁹

Hopefully, practitioners will ensure that the intent of the testator is made clear in the will, and that the will is kept up to date. This seems especially important in the context of gradual marital disruption. Unfortunately a will may be drawn to reflect a certain set of circumstances and remain unchanged despite the fact that those circumstances have changed. It is worthwhile to examine briefly some of the case law in order to determine what the outcome will be in such situations, depending of course on the particular wording of the will. The problem situation really arises when a divorce occurs after the making of the will and the will is not changed before death. It should be noted at the outset, in order to clear up any confusion, that section 26 of *The Wills Act*, which provides that the will speaks from the date of death, refers only

⁸⁷ *Supra*, note 6.

⁸⁸ R.S.O. 1970, c. 129.

⁸⁹ R.S.O. 1970, c. 224, s. 166(3).

to the "real estate and personal estate comprised in it"; it does *not* refer to the beneficiaries who may be involved.

If the bequest is to "A.B., my wife" it is fairly well settled that A.B. will take, whether or not she happens to be the wife at the death of the testator. According to *Jarman*:

As a general rule, *veritas nominis tollit errorem demonstrationis*; so that where there is a person to answer to the name, it will be immaterial that any further description does not precisely apply It is on this principle that a gift to A.B. by name, described as the wife . . . of the testator . . . is not in general affected by the fact of the legatee not answering the description.⁹⁰

In *Re Smalley*⁹¹ the testator left his estate "to my wife Eliza Ann Smalley". In fact Eliza Ann was his common law partner; his real wife, Mary Ann, was living separate and apart under a separation agreement. The Court of Appeal put itself in the testator's "armchair" — i.e. considered secondary evidence of intention — and treated Eliza as the wife. In fact, the courts virtually always follow the name, not the description.⁹²

In *Re Bain*, the wife was named at one point, though most references in the will were to "my wife". *McRuer, C.J.H.C.*, citing many English authorities, said at 974:

. . . if on the language of the will . . . it is clear that there is some definite person that the testator had in mind at the time the will was made, that person takes, irrespective of the fact that by change of circumstances before the testator's death there might be some other person who might fulfil the description of that person, providing it is also clear that the testator's intention was to describe a particular person in the will and not describe a person who might answer to the description at a future time.⁹³

If the gift is to the wife (who is accurately described as the wife, i.e., "to A.B., my wife") expressly "during widowhood", the latter words form a condition as to the beginning and ending of her interest, so that the effect of a subsequent divorce before the gift takes effect is that she is disentitled to the gift, since she does not then become a widow.⁹⁴ If she is *not* accurately described as wife (i.e., "to A.B.") the words "during widowhood" may be read as meaning "until death or remarriage".⁹⁵

When the will merely says "to my wife" without naming her, the court will look to the context (i.e. the situation at the time the will was made) to see which individual was referred to. This will be relatively simple if there was no remarriage and there was no other person who could have answered

⁹⁰ Thomas Jarman, *A Treatise on Wills* (7th ed. London: Sweet & Maxwell, Toronto: Carswell, 1930) at 1223.

⁹¹ [1929] 2 Ch. 112 (C.A.).

⁹² See, e.g., *Reeves v. Reeves* (1908), 16 O.L.R. 588; *Re Cameron, Cameron v. the Toronto General Trusts Corp.*, [1940] O.R. 49 (C.A.).

⁹³ [1953] O.W.N. 970 at 974 (H.C.).

⁹⁴ *In Re Boddington, Boddington v. Clairat* (1884), 25 Ch. D. 685 (C.A.).

⁹⁵ *In Re Wagstaff, Wagstaff v. Jalland* [1908] 1 Ch. 162 (C.A.); but see *In Re Gale, Gale v. Gale* [1941] Ch. 209.

the description.⁹⁰ The problem may be more difficult when the will merely says "to my wife" and the testator has remarried since the will was executed. There does not appear to be a case exactly on point, and the situation will probably rarely occur in any event; however the author's opinion is that the second wife could try to argue that the word "wife" was meant to be a descriptive word that could apply to different people as the situation changed. Presumably this point would be important if the second wife wished for some reason to prevent a revocation by operation of section 20 of *The Wills Act* by exercising her right under clause (b) of that section.

* * * * *

The various sections of this study have attempted to point out and describe certain estate planning problems — both tax and non-tax — that could conceivably arise in the difficult context of marital disruptions. The study has touched on many areas of the law, and referred to legal materials ranging from the most recent property tax legislation to early wills cases. Certainly it is clear that "estate planning" encompasses a great deal of law. In the present context especially, it becomes very obvious that estate planning must of necessity extend into the considerations of the practitioner involved in marital settlements of all kinds.

⁹⁰ See *Re Marks*, [1945] O.W.N. 717 (H.C.).